Introduction and background

THE PROJECT

In March 2015, the European Commission DG Justice commissioned a team from the School of Law at the University of Leeds to undertake a comparative study on substantive insolvency law throughout the European Union (EU). Insolvency law is regulated primarily in the EU through Regulation 1346/2000 (recast as Regulation 2015/848) and it is designed to facilitate cross-border insolvency proceedings and to ensure greater co-ordination of national insolvency proceedings. The Leeds project team has worked alongside a team of 30 national reporters as well as an international advisory group. The national reporters represent each of the 28 EU Member States and two comparator countries, the United States and Norway. The national reporters and the members of the international advisory group are detailed in the list of contributors.

The Leeds project team was required by the Commission to carry out four specific tasks. The first task was the collection of data about reforms in the EU Member States that implement Commission Recommendation 2014/135/EU, issued on 12 March 2014 on a new approach to business failure and insolvency. This builds on the study carried out for the European Commission by INSOL Europe involving a comparative analysis of the relevant provisions and practices on business failure and insolvency in Member States as of December 2013.

The second task was to collect data in order to enhance the comparative law information at the disposal of the Commission in respect of matters such as the regulation, status and powers of insolvency practitioners; the duties and liabilities of directors and the recognition of disqualifications, rules on the ranking of claims/order of priorities and the conditions under which certain detrimental acts can be avoided; conditions for opening insolvency proceedings and fast-track or standardized procedures for small and medium-sized enterprises (SMEs).

The third task was the collection of data about the procedures available to over-indebted consumers explaining how over-indebtedness is dealt with in the Member States including the conditions and timeframe for
debt reduction and discharge. The data is intended to address the average length of the procedures; the involvement of creditors and the extent to which such procedures are publicized. It also considers issues such as the treatment of debtors who cannot afford to pay the costs of such procedures, and ‘no income, no assets’ debtors.

The fourth task was to carry out a horizontal cross-cutting analysis of the data, identifying areas where disparities in national laws produce problems that have impacts outside national boundaries.

The United States and Norway are used in this report as comparator countries. They are both advanced ‘first world’ economies with highly developed insolvency and regulatory frameworks. They also score well in international indices of ‘best practices’ such as the World Bank Doing Business project. In the ‘resolving insolvency’ indicator of the 2016 Doing Business Report, the two comparator countries perform well on the indicator, at 5th and 6th, respectively. The project team recognize, however, that the particular solutions adopted in either the United States or Norway may not be suitable for adoption across Europe. Therefore, careful consideration has been given to the appropriateness of all elements of US and Norwegian law as far as an EU context is concerned.

The general evaluation and analysis is intended to be sensitive to the following goals:

- improving economic performance throughout the EU;
- promoting a more competitive business environment which encourages speed of resolution of distressed businesses;
- allocating assets to their most efficient use;
- building more stable and sustainable human capital;
- ensuring firm social and economic foundations for a Europe built upon equity and justice;
- ensuring that adequate accountability mechanisms are in place in respect of businesses, funders and insolvency practitioners;
- facilitating the exercise of the ‘four freedoms’ under the fundamental principles of the EU;
- preventing the abusive exercise of putative rights under EU laws.

The intention is to achieve a greater concordance between insolvency law, the regulatory instruments of insolvency practice, and the Europe 2020 growth strategy of fostering economic recovery and sustainable growth. The objective is to facilitate a situation where economic and social systems
are adaptable, resilient and fair; where economic activity is sustainable and where human values are respected.²

BACKGROUND: JUNCKER PLAN, CAPITAL MARKETS UNION AND SINGLE MARKET STRATEGY

The current European Commission President, Jean-Claude Juncker, said on taking office that his first priority was to put growth and jobs at the centre of the policy agenda of the European Commission. Addressing insolvency and business failures contributes to this policy in the following ways:

- Fewer insolvencies should mean that workers keep their jobs and businesses can contribute to growth across the EU.
- Reducing insolvencies will see creditors and other stakeholders incurring fewer losses thereby enabling them to assist in the growth process.
- Enabling individuals to recover from over-indebtedness should ensure that they can contribute to the overall economy.
- It should also mean less dislocation in local and national communities throughout the EU.
- Reducing the divergence of national insolvency frameworks could also assist growth by contributing to the emergence of pan European equity and debt markets thereby reducing uncertainty for investors who would otherwise have to assess investment risks on a country-by-country basis.

Furthermore, the Five Presidents’ report of 22 June 2015 on Completing Europe’s Economic and Monetary Union lists the area of insolvency law among the most important bottlenecks preventing the integration of capital markets.

On 30 September 2015, the European Commission released its Action Plan on Building a Capital Markets Union³ in line with its top priority

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of strengthening Europe’s economy and stimulating investment to create jobs. The Action Plan stresses the fundamental importance of stronger capital markets in providing new sources of funding for business, helping to increase options for savers and making the economy more resilient. It also highlights the role of insolvency law in contributing to this process.

The free flow of capital is one of the core foundation stones on which the European Union is built. But, as the Action Plan points out, Europe’s capital markets are still relatively underdeveloped and fragmented despite the progress over the past 50 years. While the EU economy is as big as that of the United States, the EU’s equity markets are less than half the size of those in the United States and its debt markets less than a third the size. Moreover, there are even bigger gaps between individual EU Member States. The Action Plan suggests that more integrated capital markets will lead to efficiency gains. It will also support the EU’s ability to fund growth, in particular by:

- unlocking more investment from the EU and the rest of the world;
- better connecting financing to investment projects across the EU;
- making the financial system more stable;
- deepening financial integration and increasing competition.

The Action Plan proposes taking forward a legislative initiative on business insolvency that will address the most important barriers to the free flow of capital and build on national regimes that work well. It is argued that differences in the implementation of the European Commission Recommendation on a new approach to business failure and insolvency means continuing legal uncertainty and additional costs for investors in assessing their risks. The Action Plan and the accompanying staff working document\(^4\) refers to:

- persistent barriers to the efficient restructuring of viable companies in the EU, including cross-border enterprise groups;
- inefficient and divergent insolvency proceedings in the EU preventing speedier debt restructuring;
- non-performing loans being more difficult to resolve without effective restructuring and insolvency tools;

Introduction and background

- difficulties for investors in assessing credit risk, particularly in respect of cross-border investments given the fact that there are 28 divergent insolvency regimes in the EU;
- incentives for companies in financial difficulty which do not have effective early restructuring possibilities in their home country to relocate to Member States with more effective systems;
- adverse effects on minority creditors by the application of a different insolvency regime than that originally expected by creditors even though business restructuring under a different regime could be beneficial to the general body of creditors and the company as a whole;
- high costs of relocation making it very difficult if not impossible for SMEs to benefit from better restructuring possibilities in other Member States.

On the other hand, convergence of insolvency and restructuring proceedings is seen as facilitating greater legal certainty for cross-border investors and encouraging the timely restructuring of viable companies in financial distress. An insolvency regime that encourages more debt restructuring may in turn enhance the creditworthiness of viable companies by facilitating their deleveraging. Shorter debt discharge periods for individuals enable families and households to recover more quickly from the financial crisis and to benefit from, and contribute to, economic development. Moreover, if debtors are not required to hand over income for an extended period, then this increases the incentive to work and contribute to the development of societal wealth.

The EU Commission’s Single Market Strategy, published on 28 October 2015,\(^5\) also recognizes that long discharge periods can create a significant disincentive to entrepreneurial activity. It reports that a regular complaint of SMEs is the fear of punitive bankruptcy laws. Uncertainty of a second chance, and potential legal and social consequences of bankruptcy, deter entrepreneurs from trying again.\(^6\)

SMEs face a number of obstacles, including limited access to finance, complex regulation that is difficult to understand, and lack of support for innovation. The Single Market Strategy addresses this, building on the Commission Recommendation of 2014 on a new approach to business

\(^6\) *Ibid.* para. 2.2.
failure and insolvency. The Commission Recommendation targets greater coherence between national insolvency frameworks as a goal. The aim is to foster early restructuring of viable companies in financial difficulties and promote a second chance for honest entrepreneurs, but with due support for the interests of creditors and investors, so encouraging cross-border investment. Efficient and consistent insolvency frameworks across the EU are also seen as allowing better assessment of credit risks and providing a reduction in cost in assisting over-indebted businesses. This is further supported by the Action Plan on Building a Capital Markets Union which, as has been noted, identifies divergent approaches to insolvency laws as a barrier to cross-border investment.

The Single Market Strategy sets out the priorities of the EU Commission: increasing jobs, growth and investment. A number of initiatives, underpinned by ‘better regulation’, are being pursued, including restructuring and second chance. These will have the aim of encouraging innovation, whilst still accommodating failure, and so supporting entrepreneurial confidence to start again.

The Banking Union Communication issued on 24 November 2015 also confirms that: (i) there is a need for greater convergence in insolvency law and restructuring proceedings across Member States; (ii) the inefficiency and divergence of insolvency laws make it harder to assess and manage credit risk; and (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.

METHODOLOGY

This report is based on the data which has been obtained from reporters in 30 countries. In the main, the ‘cut-off’ date for the supply of the data was 31 October 2015 but in a number of cases more updated information was provided. The report includes analysis of that data as well as a broader

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7 C 2014 (1500).
8 Ibid. 3–4.
10 Ibid. 24–5.
consideration of the issues raised in the European Commission’s Call for Tender (JUST/2014/JCOO/PR/CIVI/0075). The reporters reported on the position in all 28 Member States and two non-EU countries and identified areas where the disparity of national laws creates problems in relation to cross-border trade and investment. Collectively, the national reports investigated and analysed the various approaches on insolvency law matters in the EU Member States and the two non-EU countries used as comparators.

The national reporters were asked to prepare reports which were founded on questions and issues raised in two Questionnaires (see Appendices 1 and 2). The reports consisted of answers to those questions and issues and some other commentary that was considered relevant. The Questionnaires contained guidelines prepared by the Leeds project team to assist reporters in drawing up their reports and to achieve some common analysis of the relevant issues and a degree of uniformity of approach. Reports were received from all reporters and many reporters subsequently provided further information by way of clarification of, or additions to, their reports. The European Commission had a considerable input in approving the Questionnaires and in relation to information requests.

On receipt of the national reports, the Leeds project team commenced careful examination of the data, identifying key issues and exploring the different approaches taken in each of the Member States and the comparator states. The present report contains this analysis. Along with this introductory section, the report consists of eight substantive sections following the structure suggested by the Call to Tender. The chapter order is as follows:

1. Directors’ liability and disqualification
2. Insolvency practitioners
3. Ranking of claims and order of priorities
4. Avoidance and adjustment actions
5. Procedural issues relating to formal insolvency proceedings
6. The Commission Recommendation on a new approach to business failure and insolvency
7. Second chance for entrepreneurs
8. Consumer over-indebtedness

The report attempts, *inter alia*, to identify and analyse where appropriate and possible:

- similar or different approaches in Member States on particular issues such as ‘official’ licensing procedures for insolvency practitioners;
indicators of success of particular approaches to relevant issues, including indicators which have an internal market impact (e.g. restructuring procedures which encourage foreign investment or reduce debt overhang);

‘best practices’ in the way that Member States have addressed issues, supported by evidence relating to the indicators of success identified;

‘difficulties’ that exist or appear to exist in the way that Member States have addressed issues, in particular from the perspective of the need to ensure a smooth functioning of the internal market;

gaps that may exist in the handling of specific matters in any or all of the Member States and the problems or potential risks they create;

how insolvency law may facilitate responsible risk-taking by entrepreneurs even in circumstances where previous business ventures have failed, that is a second (or more) chance;

inefficiencies in the way in which particular matters have been addressed, such as the absence of any effective mechanism for consumer debt discharge;

advantages and disadvantages of different approaches in dealing with an issue such as simplified or specifically designed procedures for the relief of consumer over-indebtedness;

possible impacts of different national approaches (including different levels of efficiency of insolvency procedures) on the functioning of the internal market.

The report builds on complementary policy initiatives by the European Commission and work done by other bodies such as INSOL, the European Bank for Reconstruction and Development (EBRD), the United Nations Commission on International Trade Law (UNCITRAL) and the World Bank.

For instance, the work done by INSOL and its constituent bodies provides a fertile source for comparative analysis.12 INSOL Europe has carried out a comparative legal analysis on the approach to business failure and insolvency.13 INSOL International has carried out a cross-country analysis on the avoidance of antecedent transactions and cross-border insolvency.14 The countries examined include many of the leading European jurisdictions, as well as the United States. The INSOL

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12 See www.insol.org/.
14 See www.insol.org/page/33/insol-publications.
International study forms a useful comparison point for our analysis. It suggests the ingredients of a possible common European approach for the avoidance of ‘antecedent’ transactions.

The insolvency law assessments carried out by the EBRD have also been considered as part of our comparative review. The EBRD regularly conducts assessments and surveys to measure both the extensiveness and effectiveness of insolvency laws in the countries in which it operates. These countries include the EU Member States in central and Eastern Europe that form part of the old ‘Soviet bloc’.

The EBRD measures the laws against international standards and best practices as represented by the UNCITRAL Legislative Guide on Insolvency Law and the World Bank’s Principles and Guidelines for Effective Insolvency and Creditor Rights. At the same time, the EBRD recognizes that the nature and content of insolvency laws will vary from country to country in order to accommodate the rich variety of legal and cultural traditions. The EBRD assessment is based on comprehensive guidelines, developed from the international benchmarks, measuring the extent to which a given country’s laws and regulations are in compliance with these benchmarks and standards. The EBRD also aims to go beyond the ‘law on the books’. It assesses how the laws in each country, together with the local institutional framework including rules of procedure for courts and insolvency administrators, work in tandem to create a functional insolvency regime.

More recently, the EBRD has identified a set of principles that will guide law-makers in formulating and applying standards for the qualifications, appointment, conduct, supervision and regulation of insolvency practitioners. These principles single out the main issues that should be addressed in a legal regime that provides for the appointment of persons to take responsibility for the administration of an insolvent estate. They are not intended to be exhaustive, however, and simply serve as guidelines. Nevertheless, they provide an indication of the sorts of measures that may be appropriate for adoption at the EU level in respect of the regulation of insolvency practitioners.

This report addresses these principles and also the Principles and Best Practices for Insolvency Office Holders (IOHs) in Europe developed by a team from Leiden University in conjunction with INSOL Europe.

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Leiden Principles and Best Practices are intended to serve as a sound benchmark for the profession, as a way of strengthening public confidence and to focus the debate on possible future binding rules for IOHs at a European level.\(^\text{19}\)

The analysis of the treatment of entrepreneurs and consumer over-indebtedness in this report also makes reference to the World Bank’s *Report on the Treatment of the Insolvency of Natural Persons*.\(^\text{20}\) The Report was published in 2013 by the World Bank’s Working Group on the Treatment of the Insolvency of Natural Persons, convened by the World Bank’s Insolvency and Creditor/Debtor Regimes Task Force. The study considers issues in relation to personal insolvency regimes, including, where appropriate, the treatment of entrepreneurs. Whilst this Report did not have, as its objective, recommendations for reform, it examines effective measures, potential issues and guidance on policy responses. This has been drawn upon at relevant stages of the analysis.

Our report identifies possible legislative and regulatory responses by the Commission but also has regard to the principles of subsidiarity and proportionality underpinning the EU Treaties, that is Community action is only appropriate where the objectives of the proposed action cannot be achieved satisfactorily at national level, and Community action should be proportionate to the aims to be achieved. The report will set out the advantages and disadvantages of particular types of legislative or regulatory action at European level to tackle deficiencies in the frameworks governing insolvency and consumer over-indebtedness in the Member States.

Our conclusions are sensitive to the jurisprudence emanating from the Court of Justice of the European Union (CJEU) that a mere disparity in national legislation appears insufficient to justify Community action, that is the ‘Tobacco Advertising’ case, C-380/03 *Germany v. European Parliament and Council*, judgment of 12 December 2006. The report is sensitive to local legal traditions and the history and traditions of Member States by avoiding simplistic solutions and a ‘one size fits all’ mentality. At the same time, we take note of the proposition that history is not destiny and that concrete measures to achieve real legal and regulatory improvements are possible.

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\(^{19}\) See www.tri-leiden.eu/news/news-overview/semi-final-draft-of-the-insol-europe-ioh-statement-published/. See also the INSOL Europe Turnaround Wing Guidelines for Restructuring and Turnaround Professionals.

As far as our comparator nations are concerned, the report pays appropriate regard to the fact that solutions that work well in a US or Norwegian context may not be suitable for direct or indirect transplantation in the whole of the European Union. Moreover, insolvency law in the United States may undergo significant change in the next few years due to expansion in the use of secured credit, the growth of distressed-debt markets and other externalities that have affected the effectiveness of the current law. The American Bankruptcy Institute, one of the important actors in insolvency law reform in the United States, has established a review group which has reported on the reform of Chapter 11 of the US Bankruptcy Code (see www.commission.abi.org/full-report). Chapter 11 deals with the restructuring of ailing businesses. The review group has proposed reforms with a view to achieving a better balance between the effective restructuring of business debtors, the preservation and expansion of employment, and the maximization of asset values for the benefit of all creditors and stakeholders.

CASE STUDIES AND STATISTICAL COMPARATORS

In this report, we have made appropriate use of ‘case studies’ to facilitate analysis and to highlight particular points. These case studies draw on the case law of the CJEU and on national legal literature though we were not supplied by national reporters with numerous case studies. National insolvency/bankruptcy statistics and statistics drawn from the World Bank Doing Business project, rankings and database\(^1\) have also, to some degree, informed our analysis. The great strength of the Doing Business database is that it facilitates cross-country analysis but we caution against unqualified acceptance of this database for reasons explained later.

In many cases, it has not been possible for us to draw firm conclusions in our analysis from the use of available national insolvency statistics. The reporters were generally not able to supply a significant amount of statistical information as there either seems to be a dearth of it or it is not readily available. Also, as far as the statistics that are available, they have often been compiled in a disparate way at the national level and this hampers the effectiveness of their use for comparative legal analysis.

In the United States, by contrast, national aggregate statistics are gathered by the Department of Justice and published quarterly.\(^2\) These

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\(^1\) See www.doingbusiness.org/.

provide data on the number of bankruptcy filings (in aggregate and broken down into business and non-business filings) and the number of cases pending and terminated. It is the case, however, that these statistics are compiled more to gauge case volumes with an eye on court resources rather than to measure the overall health of the economy. In addition, the US Trustee programme collates and publishes in aggregate form the outcomes from Chapter 7 asset cases.23 This data is derived from the final reports filed by trustees. Moreover, the dockets in all filed cases are publicly accessible via the Public Access to Court Electronic Records (PACER) system, thereby facilitating the production of a range of statistical information on Chapter 11 cases by academic and private providers. One of the best known of these is the UCLA-LoPucki Bankruptcy Research Database which provides information on the outcomes in large bankruptcy cases.24

The position in the EU should change in the direction of greater transparency and uniformity of approach with the ‘full’ coming into force of the recast Insolvency Regulation (Regulation (EU) 2015/848). Under the recast Regulation, Member States are required to publish certain information concerning insolvency proceedings in a ‘free’ and publicly accessible electronic register, though access to the register may be made dependent upon establishing a ‘legitimate interest’ to the competent authority.25 What constitutes a ‘legitimate interest’ is obviously prone to different interpretations in different Member States and it is not clear whether an autonomous Europe-wide interpretation is envisaged. The information to be published includes information concerning the court opening the insolvency proceedings, the date of opening and closing of proceedings, the type of proceedings, the debtor and insolvency practitioner appointed, and the deadline for lodging claims.

There is, however, no requirement to publish details of claims that have been lodged or accepted. While individual States are not precluded from requiring additional information to be included on the registers, they may charge searchers a reasonable fee for accessing these optional extras.26 Moreover, because of privacy concerns, States are not required to make available on the national register information concerning individuals not

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24 See http://lopucki.law.ucla.edu/.
25 Regulation 2015/848, arts 24–7. Under art. 86, Member States are required to provide a short description of their national legislation and procedures relating to insolvency and to keep this information regularly updated.
26 Ibid. arts 24(3) and 27(2).
exercising an independent business or professional activity, although they may do so.\textsuperscript{27}

The European Commission is tasked with the responsibility of establishing a decentralized system for the interconnection of national insolvency registers and the European e-Justice Portal is intended to serve as the central public electronic access point to information from the system. The ambition of the project means that a longer period has been given to get the system up and running. In general, the changes made by the recast Regulation come into effect two years from the date that they are published in the \textit{Official Journal}, that is from 26 June 2017. Member States, however, have 36 months to establish insolvency registers and 48 months to provide confirmation that the registers will form part of an interconnected EU Portal.\textsuperscript{28}

WORLD BANK \textbf{DOING BUSINESS PROJECT}

The World Bank \textit{Doing Business} database, reports and rankings have been used by the European Commission in its Action Plan on Building a Capital Markets Union.\textsuperscript{29} They are also used as one of a number of points of reference in this report but, as explained already, we also caution restraint in the use of the report and rankings.\textsuperscript{30}

The \textit{Doing Business Reports} and rankings have been issued annually since 2004 and the rankings purport to measure a whole host of matters and not just ‘getting credit’ and ‘resolving insolvency’. The \textit{Doing Business} website explains the methodology behind the rankings. In terms of the ‘getting credit’ and ‘resolving insolvency’ indicators, the reports and rankings are based on a more sophisticated version of the ‘legal origins’ or ‘law matters’ thesis developed by four economists, La Porta, Lopez de Silanes, Shleifer and Vishny.\textsuperscript{31} They also draw to a certain extent upon the

\begin{itemize}
\item \textsuperscript{27} \textit{Ibid}. art. 24(4) and see also art. 27(3).
\item \textsuperscript{28} \textit{Ibid}. arts 24, 25, 87 and 92.
\item \textsuperscript{29} See the statement at p. 25 of the Action Plan, COM (2015)468: ‘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.’
\end{itemize}
international standards in the field of insolvency and secured credit law that have been developed by UNCITRAL and the World Bank itself.

In general, EU countries perform well on the ‘resolving insolvency’ indicator and not so well on the ‘getting credit’ indicator.32 On the ‘resolving insolvency’ report for 2016, Finland ranks 1st, with Germany 3rd and Portugal, Denmark, Belgium and the Netherlands ranked between 8th and 11th, respectively. The United Kingdom follows at 13th and Cyprus, Austria and Sweden come 17th to 19th, respectively. Slovenia is the first of the former ‘Eastern bloc’ countries and comes in 12th, followed by the Czech Republic at 22nd. Generally on the indicator Nordic and Western European countries score much better than Eastern European ones, though in fact Malta is the lowest ranking EU Member State at 83rd.

In relation to the ‘getting credit’ indicator, New Zealand is 1st with the United States, Colombia and Rwanda as joint 2nd, and Australia and Mexico as joint 5th. The highest ranked EU countries are Romania at joint 7th and then Poland, the United Kingdom, Latvia and Hungary at joint 19th. Germany, Ireland, Denmark, Estonia, the Czech Republic, Lithuania and Bulgaria are all bunched together and follow at equal 28th. But some other EU countries fare much poorer. For instance, France, the Netherlands and Greece are ranked equal 79th. Some of the results on the ‘getting credit’ indicator seem counter-intuitive. For example, despite the recent history of violence and political instability in these countries, Colombia and Rwanda score equal 2nd.

It should be noted that the Doing Business methodology and the underlying legal origins literature on which it is based has been criticized for a supposedly US-centric methodology.33 Essentially, the Doing Business Reports use a creditor-centred approach with the highest grading given to countries that emphasize private contractual solutions rather than court-based ones. It may be that this approach is too one-dimensional. Certainly, it has been criticized for a preference for free market solutions and deregulation over other values.34 As a World Bank Independent

The first three named authors refine the ‘legal origins’ thesis and defend it against criticisms in ‘The Economic Consequences of Legal Origins’ (2008) 46 Journal of Economic Literature 285.

32 The reasons for the relatively poor performance on the ‘getting credit’ indicator are explored in Chapter 3.


34 See generally G. Sarfaty, ‘Why Culture Matters in International Institutions:
Review Panel points out, the ‘Doing Business project has, rightly or wrongly, been associated with a broad deregulation agenda’.  

The Independent Review Panel, commissioned by the World Bank, reported in 2013. Among other points, the Panel suggested that:

- The *Doing Business Report* had the potential to be misinterpreted.
- It relied on a narrow information source.
- It only measured regulations applicable to categories of business that could be captured through its methodology.
- Its data-collection methodology could be improved.
- It was not designed to help countries respond appropriately.
- The use of aggregate rankings was problematic.

The Review Panel was particularly concerned about rankings because they involve a process of aggregation across topics and this involved a value judgement about what was ‘better’ for doing business and how much better it was.

The criticisms on methodology apply with particular force to the ‘getting credit’ indicator. As the Review Panel has pointed out, this indicator measures whether a country has a credit bureau system that has collected and distributed fundamental information about credit and a secured transactions legal regime that allows entrepreneurs access to credit using movable property. In reality, it does not measure directly what the indicator claimed to address.

The relevant data is gathered through questionnaire responses by local lawyers and insolvency practitioners and then verified through a study of laws and regulations as well as publicly available information on insolvency systems. There is no attempt made to assess the

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35 *Independent Panel Review of the World Bank Doing Business Report* (World Bank, 2013), p.11. The Panel was chaired by Trevor Manuel, the former South African Minister of Finance. The *Doing Business Reports* appear to have made some adjustments in response to the Independent Panel report but the fundamentals of the project remain unaltered; see Foreword to the 2015 *Doing Business Report*, p. vii: ‘Our attention has been drawn to many critiques by the Independent Panel on Doing Business, chaired by Trevor Manuel, which submitted its report in 2013. Following this report a decision was made to set a 2-year target to improve the methodology of Doing Business without damaging the overall integrity of this valuable publication.’


actual availability of credit in a particular economy. The assessment is based on the ‘law on the books’ rather than its actual application in practice. It may be that the ‘resolving insolvency’ rankings, and the methodology behind them, are no less problematic. The data is collected in the same way as for the ‘getting credit’ indicator, and in determining the rankings, two factors are equally weighted though the second factor was only introduced into the Doing Business methodology in 2015. It purports to measure the strength of the insolvency framework in a particular country. This factor depends both implicitly and explicitly on a set of normative assumptions that some aspects of insolvency law are better or more desirable than others. It could be argued that the assessment is relatively crude and depends largely on blunt ‘all or nothing’ measures. It assumes that particular legislative solutions are superior to others and misses out subtleties and nuances in the laws of a particular State. For example, it is considered desirable that undervalue pre-insolvency transactions should be subject to the possibility of avoidance in the insolvency proceedings. No attempt is made, however, to consider whether avoidance proceedings are easy to accomplish in practice or whether they are subject to conditions such as constraints on litigation funding that make the possibility of success in an avoidance action very difficult.

The first factor is the percentage recovery by secured creditors through restructuring, liquidation or debt enforcement proceedings and has been part of the ‘resolving insolvency’ rankings since their inception. The calculation takes into account whether the business emerges from the proceedings as a going concern or whether assets were sold piecemeal. Then the costs of the proceedings are deducted and, in line with international accounting practice, regard is also had to the value lost as a result of the money being tied up in insolvency proceedings for a particular period of time.

The recovery rate for creditors is seen as a function of the outcome, time and cost of insolvency proceedings in respect of a particular kind of local company. There is no attempt to measure whether this type of company is typical of the local economy or whether different outcomes and returns could be expected in relation to different types of company.

38 See the 2016 Doing Business Report, p. v: ‘the report does not attempt to capture a number of dimensions of macroeconomic stability, the prevalence of corruption, antitrust policies or the skills of the workforce, important as all these factors are for establishing a foundation for sustainable economic development. Even within the relatively small set of indicators included in Doing Business the focus is deliberately narrow.’
The focus is also exclusively on returns to secured creditors. If the insolvency law in a particular country had a redistributionist element this would necessarily depress the returns to secured creditors and therefore lower a country’s position in the rankings. For example, recital 22 of the Preamble to the recast Insolvency Regulation (Regulation (EU) 2015/848) refers to improving the preferential rights of employees at European level in the next review of the Regulation. Depending on the particular policy option adopted, this may worsen the position of EU countries in the rankings.

Moreover, an assessment of the ‘recovery’ rate depends in large part on the subjective views of survey respondents on the returns to creditors in their particular countries. In most countries, there will not be publicly available and accurate data on this matter.

SOME CONCLUSIONS FROM THE DOING BUSINESS PROJECT DATA

While this report has drawn attention to limitations in the methodology underlying the Doing Business project and accompanying database, the use of the database enables, nevertheless, comparisons to be drawn between countries and over time.

What is shown in Table I.1 is a simplified version of the Doing Business resolving data from 2006, 2011 and 2016. The ‘strength of the insolvency framework’ criteria were only introduced into the methodology and rankings from 2015 onwards and so we do not have data in respect of these matters for 2006 and 2011. The rank indicated in the table is the overall rank of the particular country on the ‘resolving insolvency’ indicator of the 2016 Doing Business Report.

The data covers the EU countries, though in respect of Cyprus, Luxembourg and Malta the data does not go back to 2006. The two comparator countries, the United States and Norway, are also included.

The 2016 Doing Business Report suggests that there is strong correlation between performing on the Doing Business indicators and also in other international data sets capturing different dimensions of competitiveness. These include such measures as the Global Competitiveness Index and Transparency International’s Corruption Perceptions Index. The report also points to a strong link between quality and efficiency and the

Table I.1  World Bank Doing Business resolving insolvency data (years 2006, 2011, 2016)

<table>
<thead>
<tr>
<th>Economy</th>
<th>Year</th>
<th>Rank</th>
<th>Recovery rate (cents on the dollar)</th>
<th>Time (years)</th>
<th>Cost (% of estate)</th>
<th>Outcome (0 as piecemeal sale and 1 as going concern)</th>
<th>Strength of insolvency framework index (0–16)</th>
<th>Commencement of proceedings index (0–3)</th>
<th>Management of debtor’s assets index (0–6)</th>
<th>Reorganisation proceedings index (0–3)</th>
<th>Creditor participation index (0–4)</th>
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<tbody>
<tr>
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Table I.1 (continued)

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<td>Norway</td>
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‘resolving insolvency’ indicator is singled out in this respect.\textsuperscript{40} It is suggested that where there is a good legal framework for insolvency, then creditors will recover a larger share of the amount due to them at the end of the insolvency process. In this context, Finland is taken as an example. ‘Resolving insolvency there takes 11 months on average and costs 4% of the debtor’s estate, and the most likely outcome is that the company will be sold as a going concern. The average recovery rate for creditors is 90.1 cents on the dollar. This high recovery rate is paired with a high score on the strength of insolvency framework index.’\textsuperscript{41} Finnish insolvency law is said to contain a range of good practices, including the fact that debtors are allowed to avoid preferential and undervalued transactions. All creditors are permitted to vote in judicial reorganization proceedings. New finance in connection with reorganization proceedings is also permitted with such finance only being granted priority over ordinary unsecured creditors.

The 2015 \textit{Doing Business Report} in its review of the ‘resolving insolvency’ indicators also highlights the linkages between efficiency and quality.\textsuperscript{42} It points out that the recovery rate measures the percentage recouped by secured creditors through insolvency proceedings and suggests that this is a measure of efficiency because time and cost are two important components. The strength of the insolvency framework index is said to be a proxy for quality because it measures how well insolvency laws accord with internationally recognized good practices. Very few economies are said to have an insolvency system that combines both high efficiency (a recovery rate of more than 50 per cent) and low quality (a score of less than 8 of the possible 16 points on the strength of insolvency framework index).

On the other hand, the correlation is not necessarily a strong one and it is possible to point to some anomalies and possible inconsistencies in the data. For instance, Austria, France and the United Kingdom score only the relatively low mark of 11 on the strength of the insolvency framework, yet have recovery rates in excess of 70 per cent. In the case of Austria and the United Kingdom, the recovery rates are in excess of 80 per cent. Bulgaria, on the other hand, scores 13 on the strength of the insolvency framework yet has a recovery rate that is below 50 per cent. The \textit{Doing Business} team might explain Bulgaria as an example of an economy having ‘an insolvency system with low efficiency and high quality. These are economies that have well-designed laws but face challenges in

\textsuperscript{40} Ibid. 9.
\textsuperscript{41} Ibid.
implementing them effectively. Others may suggest that the example calls into question the reliability of some of the Doing Business data. For example, our research indicates that Bulgaria does not have an early stage restructuring law in line with the European Commission’s new approach to business failure and insolvency, though there may be plans in the offing to introduce such a law.

Croatia, Greece, Estonia and Latvia are also countries which on the World Bank figures are said to have better designed laws than any of Austria, France or the United Kingdom, with respective scores of 12, 12, 14 and 12 on the strength of the insolvency framework measure. At the same time, these countries have recovery rates below 50 per cent. On a more positive note, however, encouraging signs can be drawn from the World Bank figures in relation to the improvements in recovery rates over time for certain countries. In the Czech Republic, Poland, the Slovak Republic and Slovenia, the recovery rates have improved significantly since 2006. This is partly counterbalanced, however, by the fact that in Greece and Lithuania recovery rates appear to have regressed somewhat.

43 Ibid.