#insolvency #restructuring #5thsymposium

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@YseultMarique @eugevaccari86

The 5th International and Comparative Insolvency Law Symposium

Royal Holloway, University of London

Thursday PM – 25 April 2024

#insolvency #restructuring #5thsymposium

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Personal Bankruptcy

Dr. Eugenio VACCARI

Royal Holloway, University of London

Judicial Discretion Regarding the Rehabilitation of Insolvent Persons: Reviewing the South African and Australian Approaches

Prof. Clement MARUMOAGAE and Dr. Matsietso MATASANE

University of the Witwatersrand

REHABILITATION

- Automatic
- By order of the court
- *Ex Parte Le Roux* 1996 (2) SA 419 (C) 423

South African Position

- Sections 124 (1), 124(2)(*a*), 124(2)(*b*), 124(3), and 124(5) of the Insolvency Act

South African Position

- See *Ex parte le Roux* 1996(2) SA 419 (C)
- *Ex parte Greub v The Master* 1999(1) SA 746 (C)

South African Position

- Discretion
- *Charmaine Purdon* (53894/2013) [2014] ZAGPPHC 95 (24 January 2014)
- *Engelbrecht NO and Another v Naidoo and Another* (2023 - 066208) [2023] ZAGPJHC 866 (3 August 2023)

AUSTRALIAN POSITION

- Rehabilitation
- Discharge
- Annulment

AUSTRALIAN POSITION

- Annulment
  - under a formal composition or arrangement with creditors;
  - by paying debts in full
  - by an order of the Court

AUSTRALIAN POSITION

- Section 153B(1) of the Bankruptcy Act
- *Thompson v Lane (Trustee) (No 3)* [2022] FCA 128 (18 February 2022)
- *Zaghloul v Jewellery & Gift Buying Service Pty Ltd t/as Nationwide Jewellers* [2020] FCA 1045

Concluding Remarks

- Lessons & Analysis
- Conclusion

Over-indebtedness, discharge and personal insolvency in LatAm

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This presentation is divided into 3 sections (all sections relate to non-business proceedings):

1) Existing collective liquidation proceedings for natural persons in Brazil and Mexico

2) New negotiation proceedings for natural persons in Brazil and Mexico

3) Innovations in insolvency proceedings for natural persons in Chile and Colombia

Section 1

Existing collective liquidation proceedings for natural persons in Brazil and Mexico

Similarities in existing liquidation proceedings in Brazil & Mexico (1/2)

- Both have in effect a collective **liquidation** proceeding for natural persons.
  - Brazil: articles 748-786-A of the Code of Civil Procedure of 1973.
  - Mexico: *concurso civil* regulated in the codes of civil procedure of the 32 states (local law).
- The proceedings start with a judgment declaring the debtor insolvent:
  - Debtors must deliver to the trustee all non-exempt assets for distribution to creditors
  - Debtors lose management and disposition of their assets
  - The trustee has custody and management of the debtors' assets
  - The trustee represents the debtors' state (debtors loose legal capacity to perform legal actions in connection with their state)

Similarities in existing liquidation proceedings in Brazil & Mexico (2/2)

- Possibility for debtors to negotiate with creditors, but with **unanimous** approval.
- In both countries, legislation allows the possibility of exempting the family household from seizure for distribution to creditors, provided that debtors have previously undertaken certain formalities. However, there are **no statistics** on the use of such figures.
- There are **no statistics** on the use of this collective liquidation proceedings.

No discharge:

	Brazil	**Mexico**
	Debtors remain liable until statute of limitations of outstanding obligations expire (5 years). **5 years start counting as from judgment ending the proceeding**	Debtors remain liable. Creditors may reopen the proceeding if the debtor acquires assets. Statute of limitations is 10 years.

Empirical research in Mexico:

Bankruptcy proceedings for natural persons in Mexico City between 2012-2016

- Not included in statistics published by courts
- Cases registered under different names of proceedings
- 98 *possible* filings found in 75 local courts in 5 years = 0.01% of all filings
- Only 28 files were actually found
- 13 not admitted (destroyed)
- Results: no collective agreement or judgment finalizing the proceeding
  - Proceedings remained opened
  - Debtors use them to stop interest accruing
  - In most cases, creditors do not appear
    - Lack of interest
    - Portfolio has been sold (banks/ financial institutions)
    - Purchasers of portfolios are not notified

Conclusions of Section 1

- Little use
- No encouragement for debtors to file
- Lack of interest in creditors
- Lack of information

New negotiation proceedings for natural persons in Brazil and Mexico

Brazil	Mexico
• Law 14.181 of July 1, 2021 amending the Consumer Protection Code • Will co-exist with the collective liquidation proceeding	• Concurso de Acreedores (Book 5, Title Second of National Code of Civil and Family Law Procedures) approved on June 7, 2023 • Will replace the collective liquidation proceeding
Already in effect	In effect no later than April 1, 2027

Similarities in the new negotiation proceedings for natural persons in Brazil and Mexico

- New proceedings to **renegotiate** consumer debt
- Over-indebtedness is the key: impossibility of paying consumer debt as it becomes due (without compromising the minimum living expenses)
- “Payment plan must consider minimum living expenses for debtors and their families”
- The judge may impose a payment plan
- The law does not provide relief or an automatic stay during the negotiation/conciliation stage/ proceeding. Relief must be negotiated.

Differences in the new negotiation proceedings for natural persons in Brazil and Mexico

Brazil	Mexico
Not an insolvency proceeding (treatment of over-indebtedness)	Insolvency proceeding
Only for natural persons	Non-business persons
Only consumer debt (excludes real estate financing, secured debt & rural loans)	All debt must be considered
2-stage proceeding: • 1st negotiation with creditors (judge/public body) (agreement ratified before the judge) • 2nd compulsory proceeding with judge	2 alternative proceedings: • Fully out-of-court conciliation • Hybrid court proceeding with compulsory judgment
Payment plan should not exceed a **5-year term**	Payment plan should not exceed a **3-year term** (excludes alimony, secured debt, fines)
The plan must provide date on which credit history of debtor must be clean	The law binds conciliator/judge to notify credit bureau of filing and plan approval. No date for cleaning history.
• No discharge is provided or implied	• Discharge is implied

Interesting rules/ Innovations in Brazilian proceeding:

- The CNJ is encouraging states to create conciliation/ mediation centers and specialized judges to deal with Law 14.181
- Strong encouragement for creditors' participation in negotiation because unjustified creditor absences:
  - stops debt enforceability
  - penalty interest ceases to accrue
  - binds the creditor to the approved plan
  - repayment is made after repayment to creditors that attended the hearing

Problems in Brazilian proceeding:

- Excluding the proceeding from the insolvency system
- Encouragement or discouragement for creditors' participation?
- The law provides that the plan imposed on dissenting creditors **must secure full repayment of the debt** in a 5-year term:
  - first payment must be made within 180 days following approval of the plan
  - the remaining outstanding amount should be paid in monthly installments, and
  - repayment under this plan **must take place after the fulfillment of the plan approved in the conciliatory hearing**.
- No discharge: (CNJ provides no debt waiver)
- **Conclusion:** This combination of rules will render the proceeding ineffective.

Empirical research in Brazil:

Proceedings under art. 104-B of Law 14.181 in the State of Sau Paulo between March 30.2022 - March 19.2023:

- Not included in statistics published by courts
- Registered under different names of proceedings
- 371 *possible* filings found in local courts in 1 year
- Only 23 files were actually dealing with article 104-B
- **Only 1 payment plan was approved**: the debtor repaid the entire debt. Monthly income was R$1.675.49 (approx. US$335 dollars). 51% of income for repayment to creditors during 48 months. Only penalty interest was waived.
- All other plans were rejected because no full repayment could take place. Debtors were considered with bad faith.

Bertran et al., “O que Dizem as (Poucas) Sentenças?as Decisões Envolvendo os Termos“Superendividamento” e “Lei 14.181/2021” no Tribunal de Justiça de São Paulo”, in Gastaldi et al, Superendividamento dos Consumidores, Aspectos Materiais e Processuais.

Interesting rules/ Innovations in Mexican proceeding:

- Use of ADR with public/private mediators
  - Out-of-court proceeding
  - Length: 2 months
  - Payment plan (res iudicata)
- Hybrid court proceeding: judge with mediator.
  - Length: 3 months.
  - The judge may provide relief and a stay
  - Quorum for plan approval: Debtor + over 50% creditors representing 3/5 debt
- *Possibility* of discharge to the honest but unfortunate debtor
- Collective insolvency proceedings for all non-business persons
- Short term for payment plan (3 years)

Problems in Mexican proceedings:

- Not yet in effect
- Out-of-court proceeding:
  - Requires unanimous vote
  - No relief /automatic stay (except household services)
- There is no parameter for minimum living expenses for debtors and their families
- There is no provision ordering credit bureaus to clean credit history
- Inconsistencies to be construed during the application
- Requires intensive training

Section 3

Innovations in insolvency proceedings for natural persons in Chile and Colombia

CHILE

Law 20720 (2014)

Reforms:

- May 10, 2023
- Dec 30, 2023

COLOMBIA

Law 1564 de 2012

Reforms discussed in Congress

CHILE

Reform published on May 10, 2023:

- Possibility to deny discharge to a bad faith debtor during the **simplified liquidation proceeding** if:
  - Debtors' documents or information is incomplete or false.
  - Debtor destroyed or hid information or diverted assets (goes back 2 years)
  - Debtor was condemned for an insolvency-related crime
  - Lack of cooperation in the proceeding
- During **renegotiation proceeding**:
  - If no plan was approved, the proposal for liquidation and distribution of assets may include payments for no more than 6 months not exceeding 30% of debtor's income.
  - Discharge takes place after realization of assets and closing of proceeding.

COLOMBIA

The reform being discussed in the Senate includes:

- Possibility to skip renegotiation stage of proceeding. Go directly to liquidation "even if the debtor has no assets"
- Includes merchants / natural persons doing business
- Debtor may be appointed liquidator when she has no assets or no other person accepted the position. No fee would be paid to the debtor.
- Assets or income acquired after the commencement of the proceeding can only be chased for repayment of claims arising thereafter.
- Repayment of the following claims is postponed:
  - Insiders, household services, belonging to creditors that breached the stay or did not attend the proceeding, interest, consensual penalties.

Thank you

A Comparative Overview of Legislative Flaws Affecting Access to Consumer Debt Relief for Low-Income Earners in South Africa: Lessons from England

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5th International & Comparative Insolvency Law Symposium | 25th-27th April 2024

Structure of the Presentation

- Introductory Remarks
- Legislative Flaws Affecting Access to Consumer Debt Relief Measures in South Africa
- Consumer Debt Relief Measures in England
- World Bank Approach to Consumer Debt Relief
- A Law and Economics Perspective to Consumer Debt Relief
- Concluding Remarks

1. Introductory Remarks

- **Debt relief measures are important for assisting over-indebted persons to repay their debts and for integrating them into formal economic activities.**

- **Most low-income earners are over-indebted since they rely on the use of credit for survival and to attain most of their basic needs both in South Africa and England.**

- **This paper seeks to provide a comparative overview of some selected laws dealing with access to consumer debt relief for low-income earners in South Africa and England.**

- **This is done to draw some lessons from England for possible adoption in South Africa to enhance and streamline access requirements for debt relief measures in line with the World Bank guidelines.**

2. Legislative Flaws Affecting Access to Consumer Debt Relief for Low-Income Earners in South Africa

(a) Sequestration proceedings under the Insolvency Act 24 of 1936 (ss 3-12)

Sequestration proceedings constitute a primary debt relief measure for over-indebtedness natural persons in South Africa. Sequestration proceedings are the only debt relief measure that offers a debt discharge to debtors.

- **The Challenges of Proving the Advantage to Creditors Requirement.**
- **Absence of a Robust Legal Framework for Out of Court Debt Relief Measures.**
- **Absence of Alternative Debt Relief Measures**

2. Legislative Flaws Affecting Access to Consumer Debt Relief for Low-Income Earners in South Africa

- **(b) Administration orders under the Magistrates Courts Act 32 of 1944 (s 74)**

Magistrates' Courts Act empowers the Magistrate's Court to make an order for the administration of a debtor's estate and appoint an administrator to take control and manage payment of debts due to creditors.

- **An administration order is only available to debtors with debts not exceeding R50 000.**
- **There is no discharge of debt under administration orders. An administration order makes no provision for the time frame within which the repayment of debt must be done.**
- **The court-based approach curtails access to an administration order for the poor and low-income earners who cannot afford litigation costs and any other administration costs.**

2. Legislative Flaws Affecting Access to Consumer Debt Relief for Low-Income Earners in South Africa

- **(c) Debt review under the National Credit Act 34 of 2005 as amended (ss 85-88)**

- **Debt relief in the form of a debt review as regulated by the NCA has a limited scope of application.**

- **Debt review is only applicable to credit agreements that have been entered into in terms of the NCA. Debtors cannot benefit from debt review for debt relief if they entered into debts which fall outside the ambit of credit agreements.**

- **An order for debt review can only be granted to debtors whose financial affairs can be re-arranged by a debt counsellor, for example, where a debtor has a regular income or realisable assets. Low-income earners who do not have a steady income cannot fully benefit from debt review.**

2. Legislative Flaws Affecting Access to Consumer Debt Relief for Low-Income Earners in South Africa

- **(d) Debt intervention under the National Credit Act 34 of 2005 as amended (s 86A)**

- **Debt intervention resorts under the ambit of the *NCA* and applies only to unsecured credit agreements. Debts which emanate outside the scope of the *NCA* are excluded e.g. municipal fees, clothing accounts and school fees.**

- **Debt intervention comes with a monetary ceiling. Essentially, debtors whose debts exceed R50000 or who earn above R7500 will be excluded from benefiting from debt intervention.**

- **Debt intervention excludes debtors who are subject to sequestration proceedings and administration order. Such debtors will not benefit from debt extinguishment available under debt intervention.**

3. Consumer Debt Relief Measures in England

- **Insolvency Act 1986 - provides customised procedures for different debtors to deal with their debts.**
- **The English insolvency system provides for bankruptcy and three different formal statutory alternative debt relief procedures, in the form of:**
- **Individual Voluntary Arrangements (IVAs),**
- **Debt Relief Orders (DROs),**
- **Administration orders when one has a Country Court Judgement (CCJ) against their debt.**
- **Roestoff and Coetzee (2012)**
- **Contrasts and Lessons??**

4. World Bank Approach to Consumer Debt Relief

- **Insolvency laws must provide quick, open and effective debt relief for natural person debtors.**
- **Beyond debt relief, long-term debt sustainability requires efforts by borrowers, lenders, and donors to promote prudent borrowing, suitably concessional finance, sustained economic growth.**
- **Financial inclusion is a key enabler to reduce extreme poverty and boost shared prosperity.**
- **Ssebagala (2017) - World Bank (2013). *Report on the treatment of the insolvency of natural persons.***

5. A Law and Economics Perspective to Consumer Debt Relief

- **Balancing of Interests between Consumers and Creditors**
- **Pricing the Risk of Loss vs Stringent Regulatory Limits**
- **Debt Extinguishment/Discharge vs Maintaining a Viable Credit Industry**
- **Promotion of Financial Inclusion vs Curbing Reckless Credit**

6. Concluding Remarks

- **Debt relief is important in the current credit-driven society where consumers live off credit for their day-to-day needs in South Africa.**
- **Nevertheless, legislative flaws discussed above continue to make access to debt relief measures difficult for low-income earners who cannot comply with the statutory requirements for accessing such measures.**
- **Policy makers should consider legislative reform approaches taking into consideration the stated flaws and contemporary challenges that are posed by lingering socio-economic effects of covid-19 and climate change.**
- **Accessible debt relief measures should be utilised to reintegrate the low-income earners into the formal South African economic activities.**
- **The debt relief provisions under the Insolvency Act, the Magistrates Courts Act, and the NCA should be amended again to provide more seamless and easy to access debt relief measures to help low-income earners in South Africa drawing lessons from England and the World Bank position.**

Thank You!

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Human Rights, ESG and Insolvency

Prof. Jill MARSHALL

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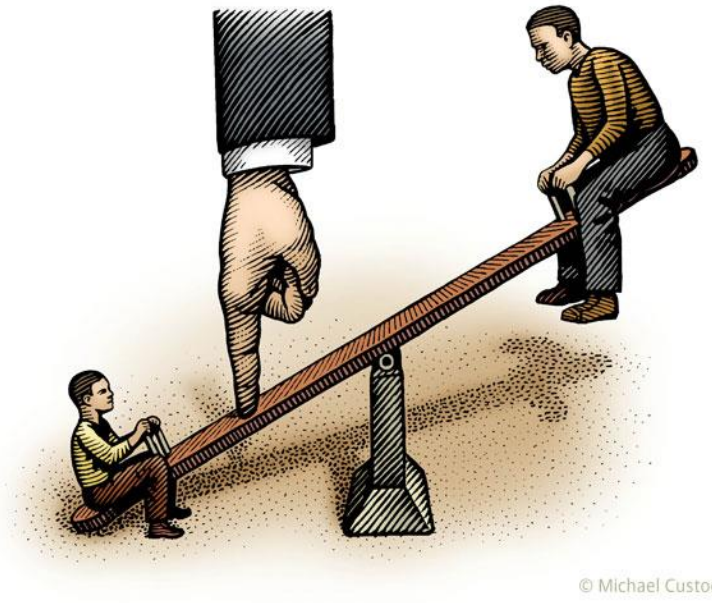
Using Vulnerability and Relative Resilience to Optimise Fairness in Insolvency and Restructuring

A Human Perspective



Introduction

- From Law and Economics to Theories of Justice
- Balancing the un-balanceable
- Challenges of the current foundational principles

EMORY UNIVERSITY | Vulnerability and the Human Condition Initiative

Why Vulnerability Theory

- Vulnerability and the Human Condition Project
- Martha Fineman, Emory University, Atlanta GA, USA
- My mentor and inspiration

Progress with Theoretical Research

- ‘Optimising Fairness in Insolvency and Restructuring: A Spotlight on Vulnerable Stakeholders’ (2022) 31(1) International Insolvency Review 1
- ‘Floating Charges and Moral Hazard: Searching for Fairness for Involuntary and Vulnerable Stakeholders’ in Jonathan Hardman and Alistair MacPherson (eds*), The Floating Charge in Scotland: New Perspectives and Current Issues* (Edinburgh University Press 2022)
- ‘Reconsidering Fairness for Vulnerable and Involuntary Stakeholders in Insolvency and Restructuring’ in Emilie Ghio and Eugenio Vaccari (eds), *The Emerging New Landscape of European Restructuring and Insolvency* (INSOL Europe 2022)
- ‘Vulnerability and Resilience: Paradigms Ensuring Internal Fairness in Corporate Insolvency and Rescue’ in Emilie Ghio, John Wood, and Jennifer L L Gant (eds), *Rethinking Insolvency Law Theories in a Changing World: Perspectives for the 21st Century* (Elgar 2023)
- ‘Vulnerability, Resilience, and Employees: Can a Higher Degree of Fairness be Achieved by Looking Beyond Traditional Insolvency Norms?’ in Jason Harris (ed), *Insolvency: A Research Agenda* (Elgar 2024) (forthcoming)

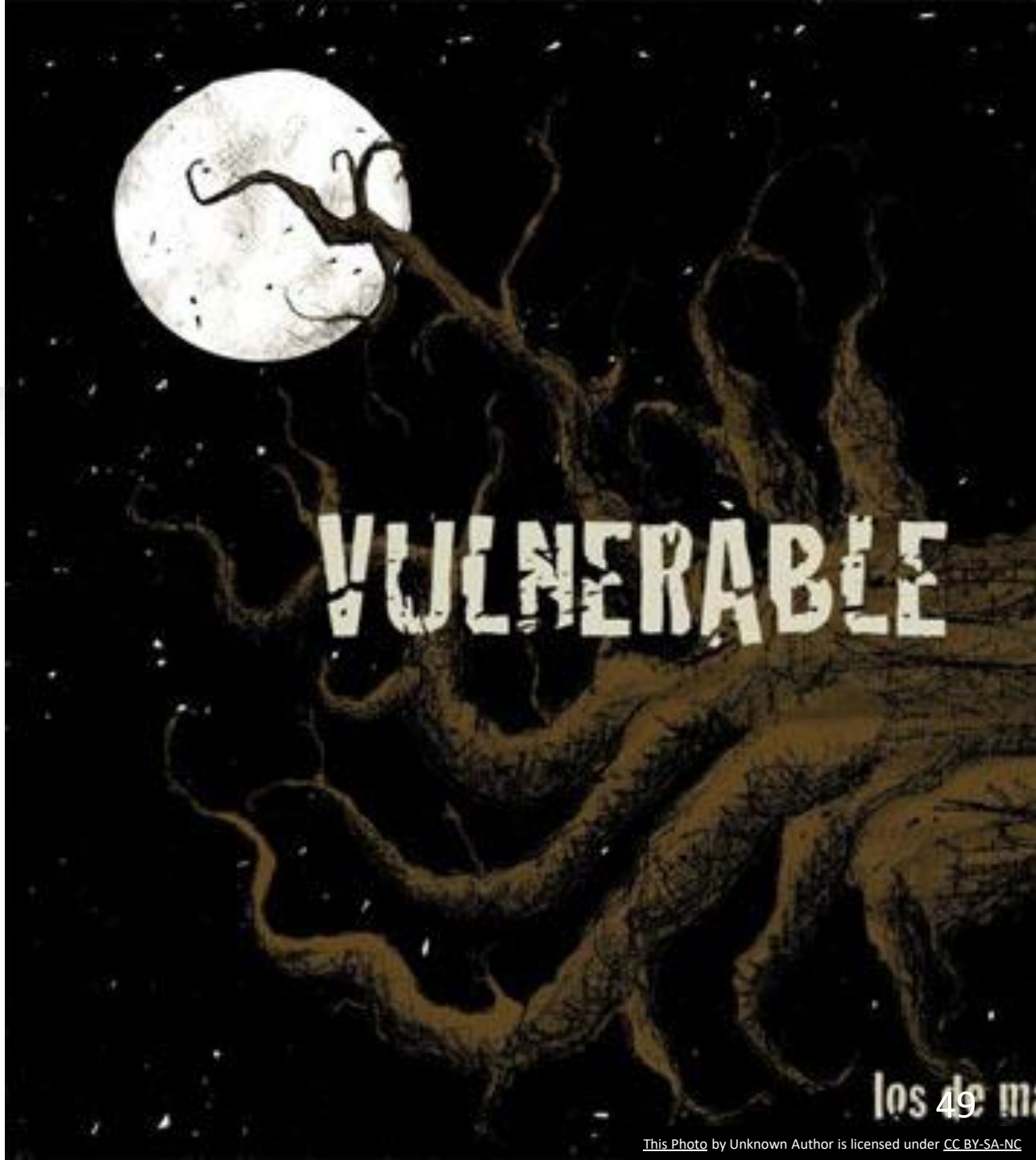
What is Vulnerability Theory?

- Vulnerability is described as:

'a universal, inevitable, enduring aspect of the human condition that must be at the heart of our concept of social and state responsibility.'

Fineman 2008

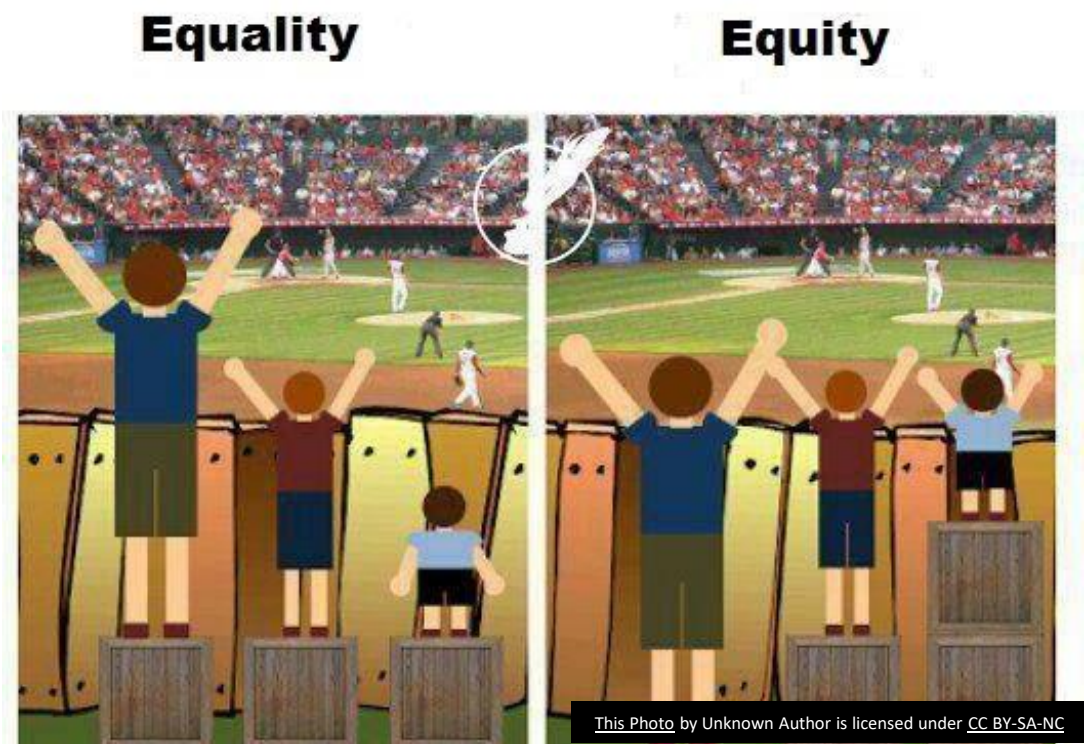
- The ability to respond to *vulnerability* demonstrates the relative *resilience* of an individual or an institution.



Equality vs Equity

- Equality vs equity:

Formal equality leaves undisturbed - and may even serve to validate – existing institutional arrangements that privilege some and disadvantage others.



Extending Vulnerability Theory to the Corporation

- Building on the ‘communitarian’ approaches to insolvency theory
- Recognising the power imbalance and the social costs/moral hazard
- Corporate rescue and preventative restructuring => progress

Involuntary, Non-Adjusting, or Undiversified Stakeholders

- The environment
- Tort creditors
- Employees
- The State (?)

Revised Terminology for the Corporate Form

- ‘Vulnerability’ and ‘resilience’ have very human connotations.
- For insolvency stakeholders, consider ‘exposure’ and...?

Capacity?

Power?

Recoverability?

Endurance?

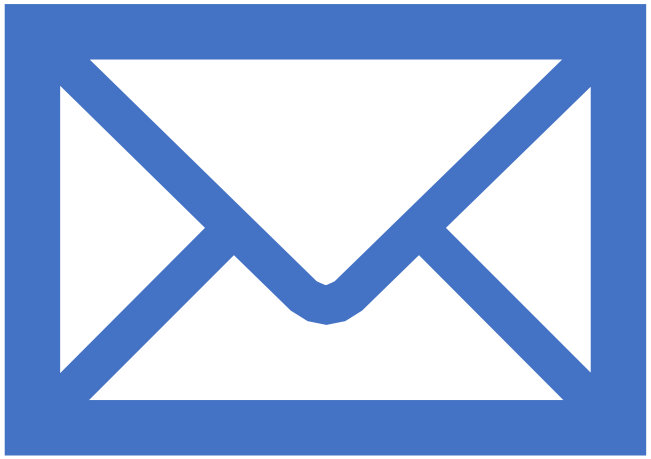
Rehabilitation?

Putting the Human Back at the Centre

'…[as] law should recognise, respond to, and, perhaps, redirect unjustified inequality, the critical issue must be whether the balance of power struck by the law was warranted.'

Fineman 2017

Thank you!



- **Dr Jennifer L L Gant**
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The ESG End Game: Bankruptcy's Externalization Problem

Adi Marcovich Gross, Postdoctoral Fellow

Wharton Initiative on Financial Policy and Regulation

OVERVIEW

- Bankruptcy's Externalization Problem: How Debtors Use Bankruptcy to Avoid Liability
- Risk Underpricing: The Impact of Bankruptcy's Externalization on Loan Pricing and Monitoring
- Solving the Externalization Problem Through State Intervention: Opportunities and Perils
- Bankruptcy Recovery Funds: A Holistic Approach to Government Activism
- Policy Implications

BANKRUPTCY'S EXTERNALIZATION PROBLEM

The Absolute Priority Rule

Discharge Rules

Texas Two-Step Bankruptcies

Abandonment

Other Tools: The Automatic Stay, Rejection, and Third-Party Releases

RISK UNDERPRICING

- Externalization distorts investment decisions, since the debtor and other stakeholders do not bear the full consequences of their actions.
- Most scholars discuss the problem through the lens of tort claims in bankruptcy (See, e.g., Bebchuck and Fried, 1996 and Buccola and Macey, 2021).
- Externalization also distorts pricing and monitoring decisions for managers, lenders, insurers, and other stakeholders, thus inhibiting the promotion of ESG goals and affecting resource allocation (See, e.g., Marcovich Gross, 2023).

RISK UNDERPRICING

- Bankruptcy's Effect on Accurate Pricing of ESG Risks in Debt Markets
- Distortion of Capital Markets Due to Underpricing
- "Bad Actors" Can Access Debt Markets at a Low Cost, Unreflective of True Behavior Costs
- Lack of Incentive for Behavioral Change

SOLVING THE EXTERNALIZATION PROBLEM THROUGH STATE INTERVENTION: OPPORTUNITIES AND PERILS

- The most common solution offered is a change in priority rules.
  - **Challenges:** Hard to promote congressional change; Reliance on judicial intervention is likely to result in inconsistent decisions; Difficult to restructure if too many claims are prioritized or not discharged; May not prevent asset partitioning; May increase credit costs; May not promote monitoring if prioritization is achieved ex-post.
- Another solution would be to impose personal liability on corporate decision makers.
  - **Challenges:** Managers can insure against civil liability and may obtain third-party releases in the plan.

SOLVING THE EXTERNALIZATION PROBLEM THROUGH STATE INTERVENTION: OPPORTUNITIES AND PERILS

- This paper advocates for a more holistic approach of government activism and provides guidelines as to how and when the government should operate in bankruptcy proceedings on behalf of individual claimants.
- Specifically, when the damage arises out of a common cause and is significant and spread among many victims. . .

EX-ANTE MODEL – GOVERNMENT SUPERFUNDS

Step 1

A. Government agencies establish designated trust funds to compensate victims and those funds will enjoy preferred status in bankruptcy.

B. Victims may recover capped damages from those funds if they assign their claims against the debtor to the state fund.

Step 2

The government could then recover the funds outside of (or in bankruptcy) with a preferred claim against the debtor.

Step 3

The superfund would distribute any excess funds to the victims.

Case study: CERCLA Superfund.

EX-POST MODEL - BANKRUPTCY RECOVERY FUNDS

- Upon bankruptcy filing, the government will provide super-priority (or administrative priority) DIP financing conditioned upon full payment to tort victims and compliance with regulatory goals.

Case Study: Pacific Gas and Electric Company (PG&E).

GOVERNMENT ACTIVISM IN THE LITERATURE

Potential Opportunities: Ellias and Triantis (2021, 2022)

- The government can employ activist tactics in bankruptcy to promote policy goals that would otherwise be impossible.

Potential Perils: Ellias and Triantis (2021, 2022), Organek (2024, forthcoming)

- Lack of consistency in the government's position.
- Conflict of interests.
- Government overreach.

PROS AND CONS: THE EX-ANTE MODEL

PROS

- Prompt compensation for victims
- Reduction in litigation costs and efficient claims processing
- Government as a more capable litigant
- Better ESG monitoring
- ESG-friendly plans

CONS

Impact on other creditors

Moral hazard

Government overreach

Cost to taxpayers

Requires legislation

PROS AND CONS: THE EX-POST MODEL

PROS

Reduction in litigation costs and efficient claims processing

Government as a more capable litigant

“Backdoor” tort priority

ESG-friendly plans

Flexibility

CONS

Impact on other creditors

Conflicts of interests

Moral hazard

Less monitoring impact

Government overreach

The government may choose to promote other goals at the expense of tort victims

Cost to taxpayers

POLICY IMPLICATIONS

- Mass Tort Cases and Third-Party Releases
- Solvent Debtors
- EPA Participation in Bankruptcy Cases
- Lender Monitoring

KEY TAKEAWAYS

- Bankruptcy's externalization problem distorts investment and monitoring decisions, thus inhibiting the promotion of ESG goals.
- The government is a more powerful actor than individual victims for negotiating better recoveries and promoting policy goals in bankruptcy.
- Increasing the government's power, while preventing conflicts with vulnerable groups, is the key to forcing debtors and lenders to internalize the costs of bad behavior.

Thank You!

Applying the ESG Double Materiality Principle and ESG Ratings to Cross-Border Insurance Recovery

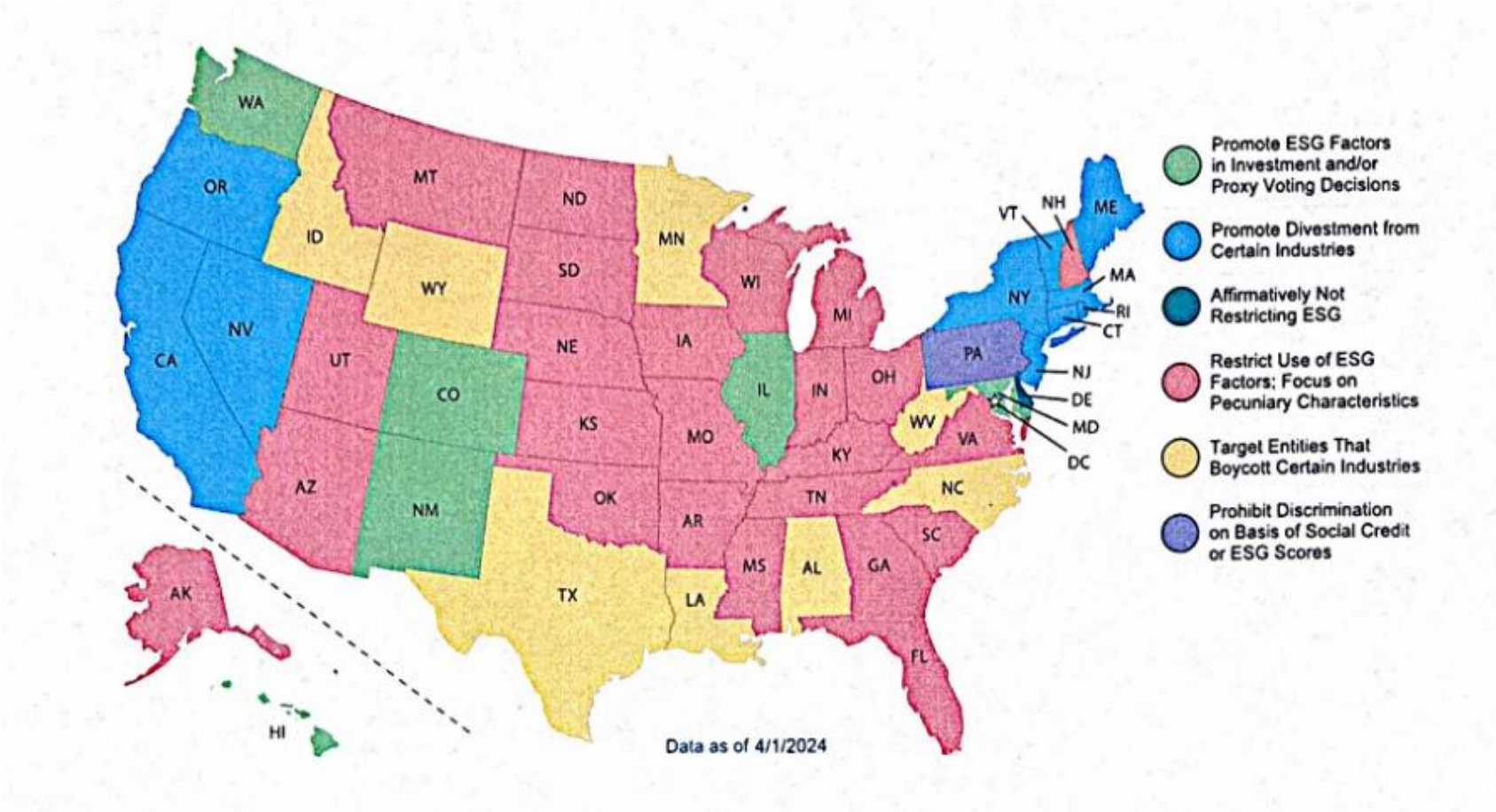
Christoph Henkel & Lidija Simunovic

Cross-Border Insolvency Risk for P&C Insurance Companies

Climate Risk & Disparity


BABCOCK RANCH

Polarized ESG Regulation in the United States



Source: https://www.ropesgray.com/en/sites/navigating-state-regulation-of-esg

The Double Materiality Principle

- **Physical Risk**
  - Relating to potential damage caused by extreme weather events, such as Hurricane Ian in 2022

- **Transition Risk**
  - Arising from corporate “policy, technology, and preference changes toward less carbon-intensive economies” or toward net-zero economies

UNEP FI Principles for Sustainable Insurance

What is Sustainable Insurance?

Sustainable insurance is a strategic approach where all activities in the insurance value chain, including interactions with stakeholders, are done in a responsible and forward-looking way by identifying, assessing, managing and monitoring risks and opportunities associated with environmental, social and governance issues. Sustainable insurance aims to reduce risk, develop innovative solutions, improve business performance, and contribute to environmental, social and economic sustainability.

Source: https://www.unepfi.org/insurance/insurance/

U.S. Regulation of Insurance Insolvency

- The Federal Bankruptcy Act excludes insurers from eligibility
- Non-uniform State statutes which provide for the management and distribution of the assets of any insolvent insurer
- Insurance policies are terminated, and policyholders become unsecured creditors to the extent of the reserve value of their policies
- Insurance assets may be transferred to other insurers or group of insurers (assumption of liability)
- All U.S. States have ***State Guarantee Funds*** providing some last-resort protection against the risk of insolvency
  - ➢ Coordinated by National Conference of Insurance Guarantee Funds (non-profit)
  - ➢ Typically, policyholders may recover up to $300,000 from a Guarantee Fund
  - ➢ ***Financed through assessments on insurers licensed to do business in the State***

Insurance Insolvency Regulations in EU Member States

- Croatia

  - Croatian Agency for the Supervision of Financial Services (CASFS) may initiate insolvency proceedings under the Croatian Insurance and Bankruptcy Acts
  - Mandatory Insurance Guarantee Fund

- Germany

  - Supervisory authorities (BaFin or State supervisory authorities) may initiate insolvency proceedings under the German Insurance Supervision Act (VAG) and the Insolvency Code (InsO)
  - Mandatory Insurance Guarantee Funds

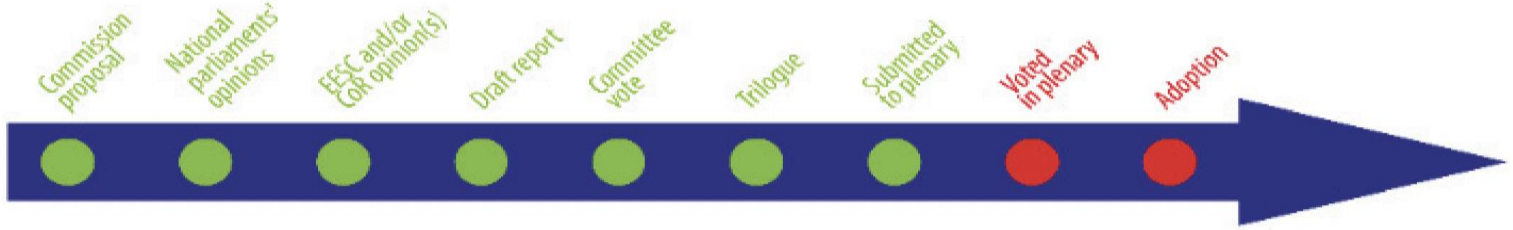
Insurance Insolvency Regulations in EU Member States

- France
  - ➢The French Prudential Supervision and Resolution Authority (ACPR) may revoke the accreditation of insurance company, which triggers bankruptcy.
  - ➢Mandatory Insurance Guarantee Fund

- The Netherlands
  - ➢The Bankruptcy Act contains specific provisions for the bankruptcy of insurance companies.
  - ➢According to the Financial Supervision Act (Wet op het financieel toezicht) insurance companies may not file for suspension of payments. The Act provides for separate proceedings for insurance companies prior to bankruptcy: the interim procedure and certain intervention measures.
  - ➢No guarantee scheme

Insurance Recovery & Resolution Dircetive Motives and Goals

- Harmonize EU Member States' laws on recovery and resolution of insurance companies
- Allow for preemptive recovery planning and resolution
- Provide a common set of resolution tools
- Promote cross-border cooperation and coordination in insolvency proceedings
- Allow for a tronger coordination role of EIOPA
- Incentivize financing arrangements and insurance guarantee schemes



What powers will resolution authorities have?

The resolution tools	
Solvent run-off	• Withdrawal of authorisation to write new business • Run-off of existing contracts
Sale of business	• Transfer of shares or all or part of assets/liabilities to purchaser on commercial terms • If a partial transfer, residual entity wound up.
Bridge undertaking	• Transfer of shares or all or part of assets/liabilities to a bridge institution controlled by public authorities • Aim to achieve an eventual sale • If a partial transfer, residual entity wound up.
Asset and liability separation	• Transfer of all or part of assets/liabilities to asset management vehicles(s) controlled by public authorities • Aim to maximise value by sale or orderly wind down.
Write-down and conversion (bail-in)	• Power to write-down capital instruments and eligible liabilities (or convert them to shares) to recapitalise entity or a bridge institution • All insurance and other liabilities are eligible except certain secured, short-term and operational liabilities

https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2021/10/the-new-eu-insurance-recovery-and-resolution-directive.pdf

THE EU LEGISLATIVE RELATED TO ESG IN INSURANCE

- The European Green Deal
- Sustainable Finance Disclosure Regulation (SFDR)
- Corporate Sustainable Reporting Directive (CSDR)
- Taxonomy Regulation

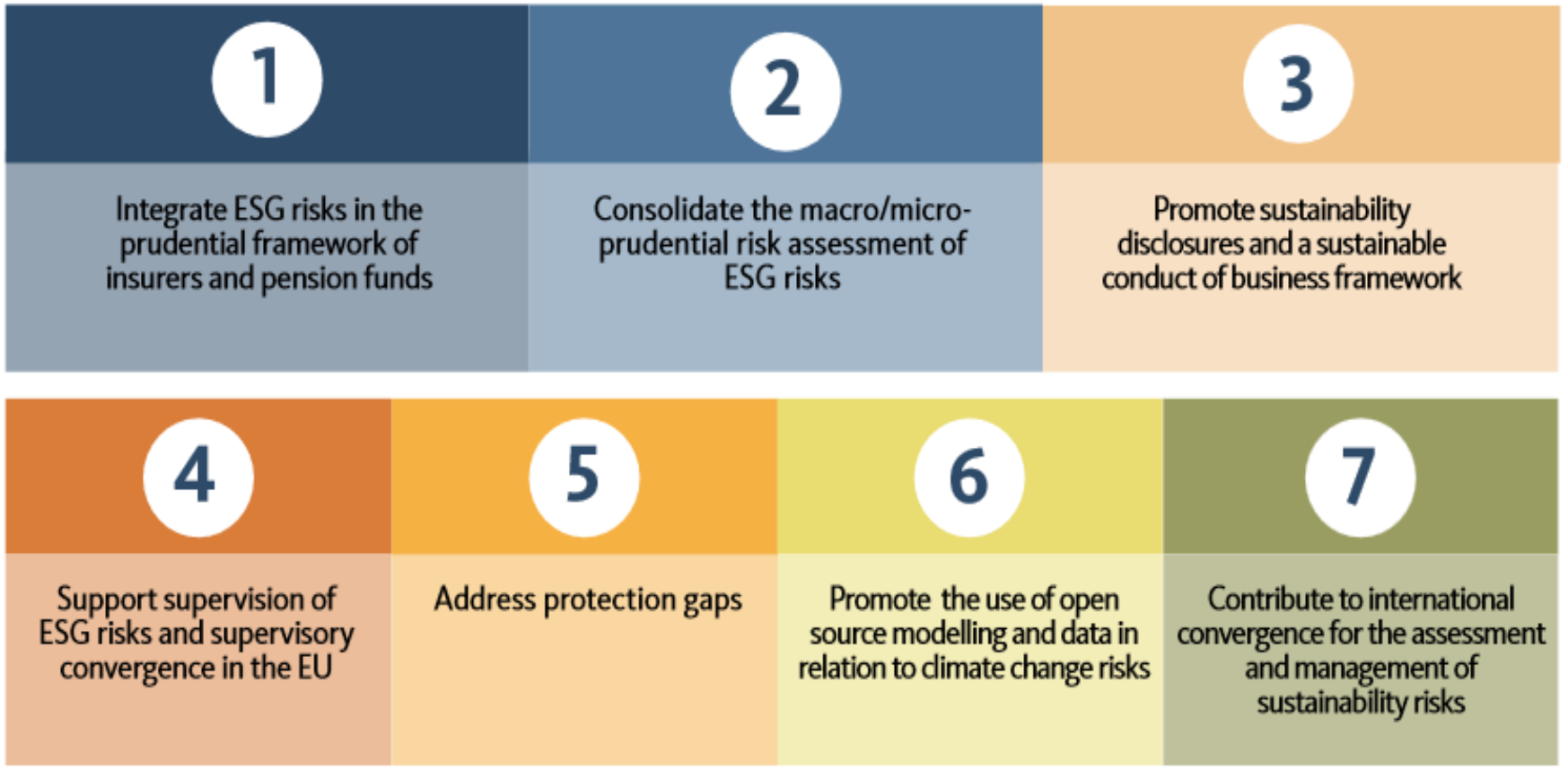
Benefits of ESG Reporting

- Building customer relationships (reputation)
- Boosting financial performance
  - ➢96% of G250 companies report on sustainability or ESG matters
  - ➢44% of insurance CEOs believe that ESG programs improve financial performance and are looking for better and credible metrics on reporting about these programs
- Sustainability drives competitiveness and increases sales
  - ➢Large growing demand from customers for green or ethical insurance and investment products
- Significant non-compliance risk (i.e. regulatory and financial penalties)
  - ➢Largest damage to reputation and perception of the brand among investors, customers and other stakeholders
  - ➢Greenwashing – dishonest practice
- Organizations story to the market and impact on share price
- Demonstrating resiliency and viable sustainability-conscious operating models (Ratings)

ESG Ratings, Role and Future ("ESGness")

- Rating agencies current indices are not uniform or harmonized and split markets (the only possible commonality may be uniform regulatory reporting metrics)
- S&P has started incorporating ESG considerations into credit ratings, eliminating the alphanumeric scale used by other rating agencies focusing on text descriptions
- ESG includes many complex factors, from climate change, to workers rights, health care (contraception and abortion), and corporate governance (limitation of numerical scales)
- Implement IOSCO definition of ESG ratings with regulatory oversight on rating agencies and data providers
- Multiple types and future applications of ESG Ratings:
  - Basis for guarantee fund contributions and borrowing costs
  - Viability determinations & mandatory preventative recovery planning (stress testing)
  - Informing consumers about reliance and viability of their P&C insurers (outward-looking)

EIOPA Deliverables & Priorities



Source: EIOPA: In Brief "Sustainable Finance Activities 2022-2024, https://www.eiopa.europa.eu/system/files/2021-12/eiopa-sustainable-finance-activities-2022-2024.pdf

THANK YOU!

Climate Lawsuits and Decisions

- Since 2019 more than 1400 climate lawsuits were filed around the world

- *The State Of The Netherlands vs. Stichting Urgenda (2019)* ***(recognizing the obligation of The Netherlands "to reduce greenhouse gas emissions from its territory in proportion to its share of responsibility.")***

- *Verein Klima Seniorinnen Schweiz and Others v. Switzerland (2024)* ***(recognizing that the European Convention on the Protection of Human Rights and Fundamental Freedoms "encompasses a right to effective protection by the State authorities from the serious adverse effects of climate change on lives, health, well-being and quality of life.")***

INSURANCE INSOLVENCY PROCEDURES IN THE EU

The existing regulatory framework for **the insurance industry** in the European Union (EU) on the EU level is governed by the Directive of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II, Directive 2009/138/EC), which entered into force on 1 January 2016.

The framework for the recovery and resolution of insurance companies is currently governed by national laws. This has resulted in significant discrepancies across EU Member States in terms of substantive and procedural laws.

In 2020, the Commission initiated a review of Solvency II and on 22 September 2021 proposed a directive establishing a framework for the recovery and resolution of insurance and reinsurance undertakings (COM(2021)0582) – so called ***'insurance recovery and resolution directive' (IRRD).***

Source: https://www.europarl.europa.eu/RegData/etudes/BRIE/2022/739273/EPRS_BRI(2022)739273_EN.pdf

Corporate Sustainable Reporting Directive

- *Insurance companies must also include sustainability reporting in their management report must be published together with the companies' financial statements and corporate governance statement in their annual reports, and which must be based on the double materiality principle.*

- *As a result, insurers must not only report their impact on people and the environment but also outline possible effects of sustainability on their cash flows, development, and performance that may be relevant to shareholders, lenders, and other stakeholders.*

USES OF THE TAXONOMY BY INSURENCE COMPANIES

Use	Scope
Product disclosure	Mandatory: Life insurance undertakings selling IBIPs marketed as "sustainable investment" or pursuing environmental objectives; for other IBIPs, comply or explain.
Company disclosure	Mandatory: - Life insurance undertakings selling IBIPs marketed as "sustainable investment" or pursuing environmental objectives; for other life insurers selling IBIPs comply or explain. - Insurance and reinsurance undertakings with more than 500 employees. Voluntary: all other insurance and reinsurance undertakings.
Investment strategy **- Consideration of long-term impact of investments** **- Supporting stewardship**	Voluntary
Risk management **- Identification of sustainability risks**	Voluntary

Source: https://www.eiopa.europa.eu/document/download/84eb6794-e70b-49c6-935b-368eaa031fbc_en?filename=%20The%20EU%20sustainable%20finance%20taxonomy%20from%20the%20perspective%20of%20the%20insurance%20and%20reinsurance%20sector

WHY ESG RATINGS OF INSURANCE COMPANIES SHOULD BE ESTABLISHED?

- to provide better regulatory oversight,
- to formulate more efficient pre-emptive recovery plans in domestic and cross border insurance undertakings,
- to inform consumers about the viability of their casualty and property insurance,
- to directly impact the level of contributions raised from the insurance industry to establish or maintain insurance guarantee schemes as last-resort protection of policyholders at the state or member state level if insurance companies fail,
- to avoid problems seen in the credit rating industry during the Great Recession,
-to accomplish requirements from the CSRD

Jen LL GANT
University of Derby

Adi MARCOVICH GROSS
Wharton, University of Pennsylvania

Christoph HENKEL and Lidija SIMUNOVIC
Drake University & University of Osijek


coffee break

#insolvency #restructuring #5thsymposium

@walters_adrian; @HenkelProfessor; @LCoordes;
@YseultMarique @eugevaccari86

Creditors' Interests in Insolvency

Prof. Irit MEVORACH

University of Warwick

Developing Restructuring Law in Silos: Part 26A and Unexpired Leases

Sarah Paterson (London School of Economics)

&

Adrian Walters (Chicago-Kent College of Law)

The Silo Effect

The treatment of unexpired leases in Part 26A has developed in domain-specific and geographical silos.

The Silo Effect

- This is a problem because…

1. What we do with restructuring law *ex post* affects behaviour outside the restructuring domain:
   - We accept that the concern about *ex ante* effects is contested.
   - But we consider it incontestable that scholars and policy makers should pay some regard to this concern.

The Silo Effect

- This is a problem because…

2. Domestic law reformers tend to draw on foreign influences (e.g. the influence of Chapter 11 on UK restructuring plans) at the "macro" level but fail to focus on the "micro" detail of the foreign law and foreign legal system.

Dramatic differences in the way unexpired leases are treated inside and outside of restructuring

- Surrender
- Bargaining power
- Cost
- Information asymmetry

	Outside Part 26A	Inside Part 26A	Outside Chapter 11	Inside Chapter 11
Surrender	No right of surrender	Functional equivalent	State dependent	Rejection
Bargaining power	Limited	Bundle leases and propose plan treatment. Landlord right to terminate	Limited	Collectivises rejection But modification requires landlord consent. Debtor right to terminate.
Cost	Expensive	Risk of expensive challenge	Expensive	Cap on damages claim
Information asymmetry	Reduced	Demands less engagement	Reduced	Demands less engagement

Do these differences matter?

- Restructuring solely to deal with unexpired leases:
  - Part 26A high risk: selectivity; modification in plan; generous cram down rules
  - Moderated in Chapter 11: inclusive nature and tighter cram down rules

- Restructuring leading the market ("tail wagging dog")
  - Reduced rents in Part 26A and other tenants
  - Capped damages claim and decision-making period in Chapter 11

Do these differences matter?

- Foundational questions:
  - Property and/or contract?
  - Are leases financial liabilities or operating expenses?

Some immediate suggestions

- Relevant alternative:
  - Not just distributions.
  - Would landlords receive better modified terms in a sale?

- Creditors unaffected by the restructuring plan:
  - Are they getting too good a deal?

Some immediate suggestions

- Transfer of value:
  - Courts should consider whether plans entail a transfer of value from lessors to equity.

- Target claim unimpairment:
  - Do not permit target claim unimpairment (Mattress Firm) to become widespread.

Transfer of value to those who will own equity

- Benefit of using EBITDAR (Mike Harmon)
  - Does lease rejection improve fundamental profitability of firm?
  - If it does, transfer of value

Re Sunbird Services Ltd [2020] EWHC 2493 (Ch) at [23]

… by this time the Company was already adopting a very different approach of engagement with selected creditors which it thought might be supportive of its proposals, whilst keeping creditors which it considered might be hostile at arm's length

Silo busting

Restructuring law and the case for 'contractualization' of commercial property leases?

Lessons from Commercial Rent (Coronavirus) Act 2022 and code of practice?

Reassess damages cap in Chapter 11?

Treatment of leases in the rest of the world?

Image by
Andrew Stutesman
on Unsplash

Insolvent Litigation Funding and Protection of Creditors' Interests: Comparative Notes from an Australian/Canadian Perspective

Jassmine Girgis (University of Calgary)
and
Sulette Lombard (University of South Australia)

Overview

- Introduction
- Canada
  - Advent of TPLF
  - TPLF concerns and how they are addressed
- Australia
  - Advent of TPLF
  - TPLF concerns and how they are addressed
- Conclusion

Professional Litigation Funding

<u>Professional litigation funding involves:</u>

- a funder with no personal interest in the litigation
- covering all or part of the costs including lawyers' fees, expert witness fees and other disbursements
- in exchange for a share of the litigation proceedings
- *if the litigation is unsuccessful, funder will be liable for remaining fees, including adverse costs orders*

Canada – Advent of TPLF

The Supreme Court of Canada ("SCC") formally approved insolvent litigation funding in *9354-9186 Quebec inc v Callidus Capital Corp*, 2020 SCC 10 ("*Bluberi*"):

The SCC noted that where there is a "single litigation asset that could be monetized for the benefit of creditors", conceptualizing interim financing as litigation funding could occur because "litigation funding furthers the basic purpose of interim financing: allowing the debtor to realize the value of its assets" (*Bluberi* at para 96).

Canada – Advent of TPLF

LFAs can be approved as interim financing when supervising judges determines it would be fair and appropriate, having regard to circumstances and objectives of the *Companies' Creditors Arrangement Act.*

When deciding whether to make an order for interim financing, courts must consider these factors (s 11.2(4) of the *CCAA*):

(a) the period during which the company is expected to be subject to proceedings under this Act;

(b) how the company's business and financial affairs are to be managed during the proceedings;

(c) whether the company's management has the confidence of its major creditors;

(d) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;

(e) the nature and value of the company's property;

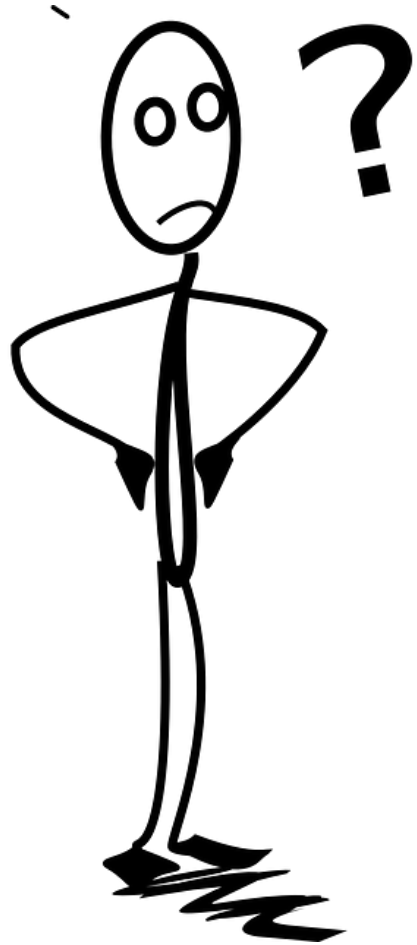
(f) whether any creditor would be materially prejudiced as a result of the security or charge; and

(g) the monitor's report …, if any.

TPLF Concerns & How They're Addressed: Canada

No industry standard for LFAs

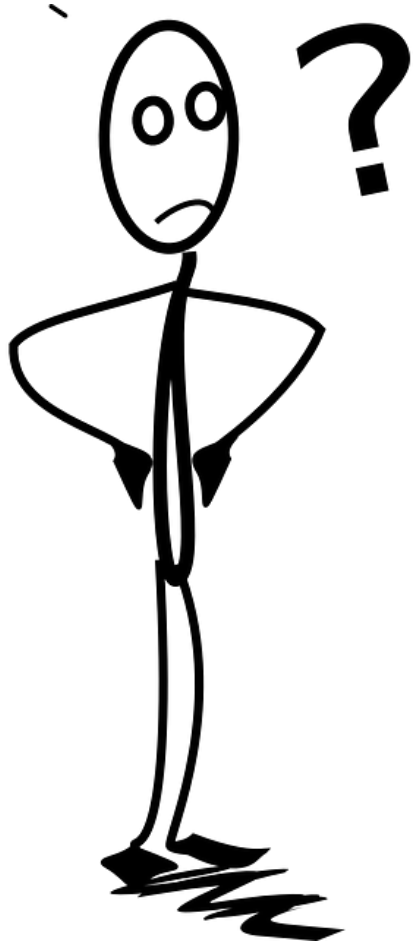
- Access to Justice & Integrity of Justice System
- Adverse cost orders
- Capital adequacy of funder
- Process for reaching LFA & LFA Terms



TPLF Concerns & How They're Addressed: Canada

Access to Justice & Integrity of Justice System

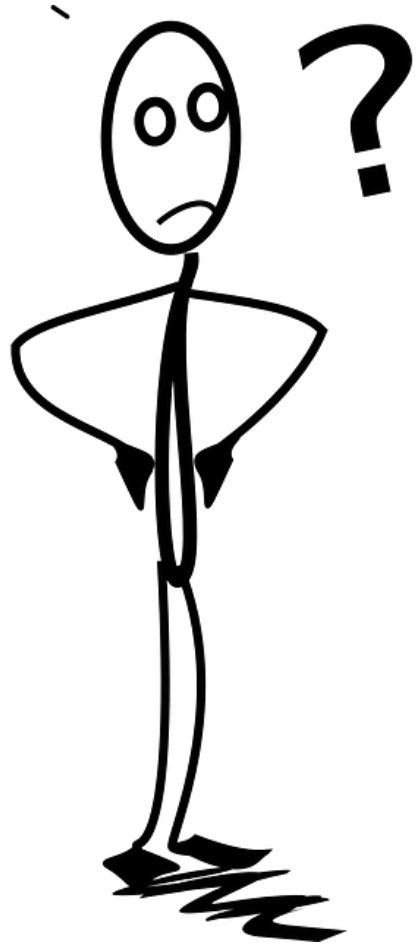
- Can this litigation be pursued without the funding in question? Or without funding altogether?



TPLF Concerns & How They're Addressed: Canada

Adverse Costs

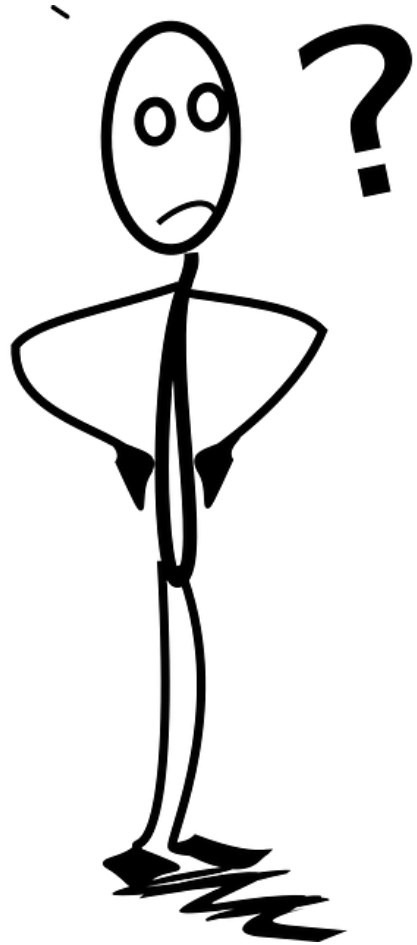
- Courts do not allow proposed funding agreements unless there are provisions for adverse costs.



TPLF Concerns & How They're Addressed: Canada

Capital Adequacy

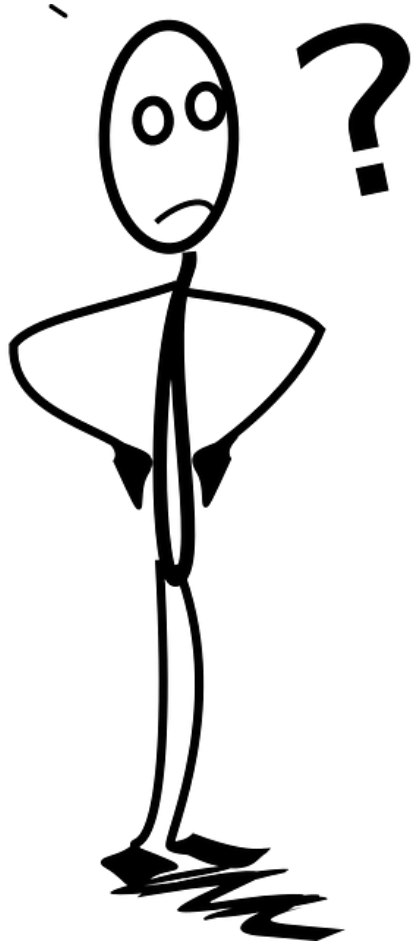
- Courts do not require information about the solvency or reputation of the funder to ensure they can cover these costs.



TPLF Concerns & How They're Addressed: Canada

Process for Reaching LFA & LFA Terms

- Courts consider efforts made by debtor in obtaining competitive funding, process of negotiation, relatedness of the parties.



Australia – Advent of TPLF

The ‘insolvency exception’ - *Re Movitor Pty Ltd* (1996) 64 FCR 380, 391:

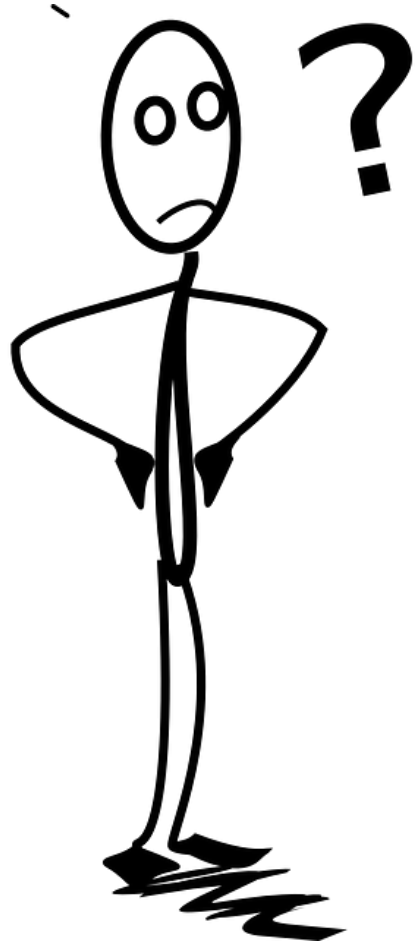
…the reason why the sale of a bare right of action by a trustee in bankruptcy or a liquidator does not involve maintenance and champerty is that, being a sale under statutory authority, to do that which Parliament has authorised, either expressly or by necessary implication, cannot involve the doing of anything that is unlawful.

Subsequent endorsement of LFAs in other contexts by the Australian High Court

Function of TPLF in context of insolvency

TPLF Concerns: Australia

- Size of funding premium
- Extent of control exercised by funder
- Adverse cost orders
- Capital adequacy of funder



Protection of Creditors

- Court approval
- Creditor involvement
- Role of liquidator as litigant

Conclusion

Need for additional regulation?

When remedies make you sick:

side effects from creditors' remedies introduced in the Brazilian Bankruptcy Law reform

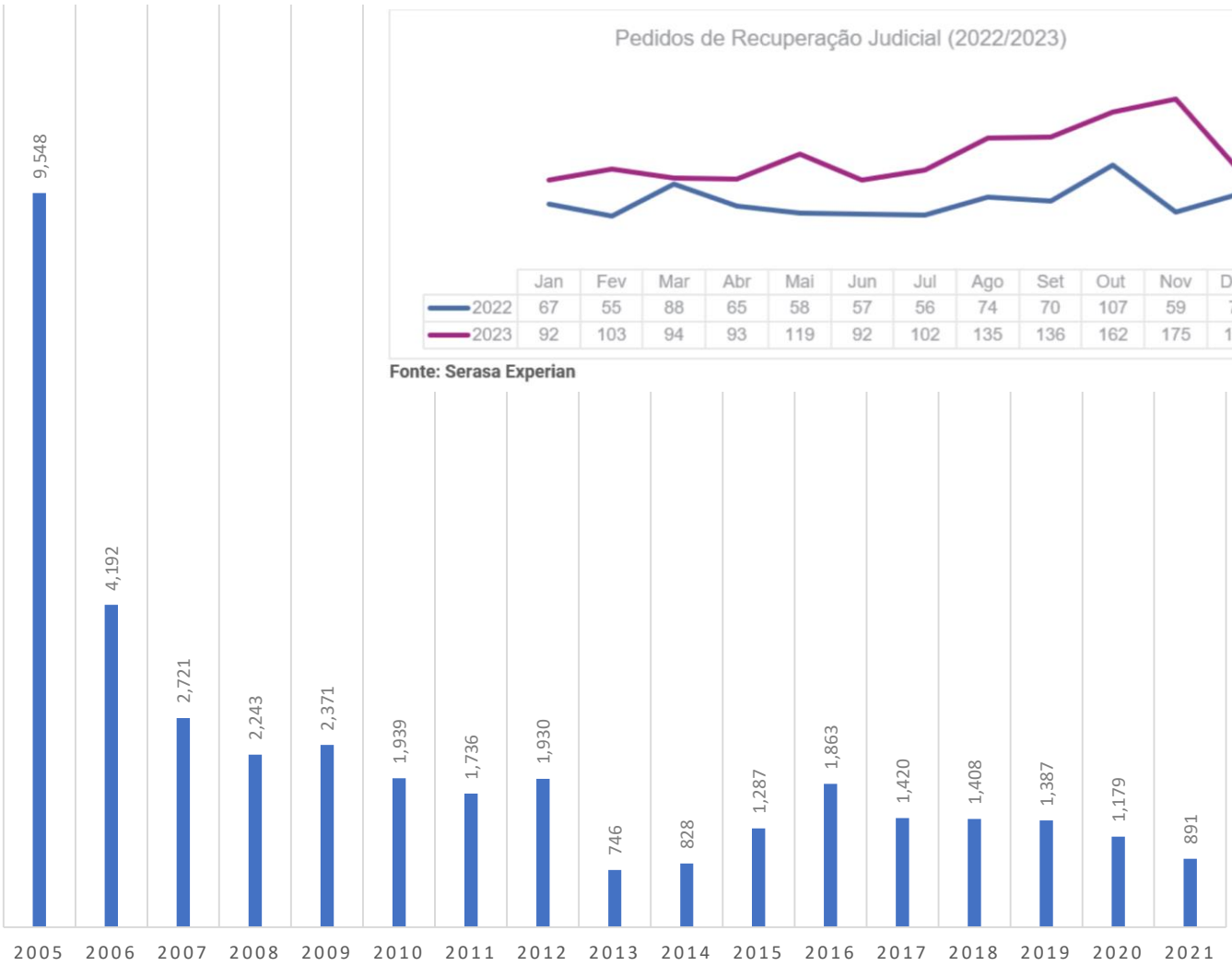
Ana Elisa Laquimia

Brazilian Experience: The Brazilian Bankruptcy Law (n. 11.101/05)

- ✓ More than 40 thousand filings for judicial reorganization ("RJ") since the enactment of Brazilian Bankruptcy Law n. 11.101/05 ("BBL")
- ✓ Proceeding is based on the creditors' liberty and ability to decide whether a Company should be restructured as a going concern or liquidated
- ✓ Justice should not intervene in the economic merits of the Plans proposed

DATA from Serasa Experian (available at: <https://www.serasaexperian.com.br/conteudos/indicadores-economicos/>)

NUMBER OF JUDICIAL REORGANIZATIONS FILED IN BRAZIL



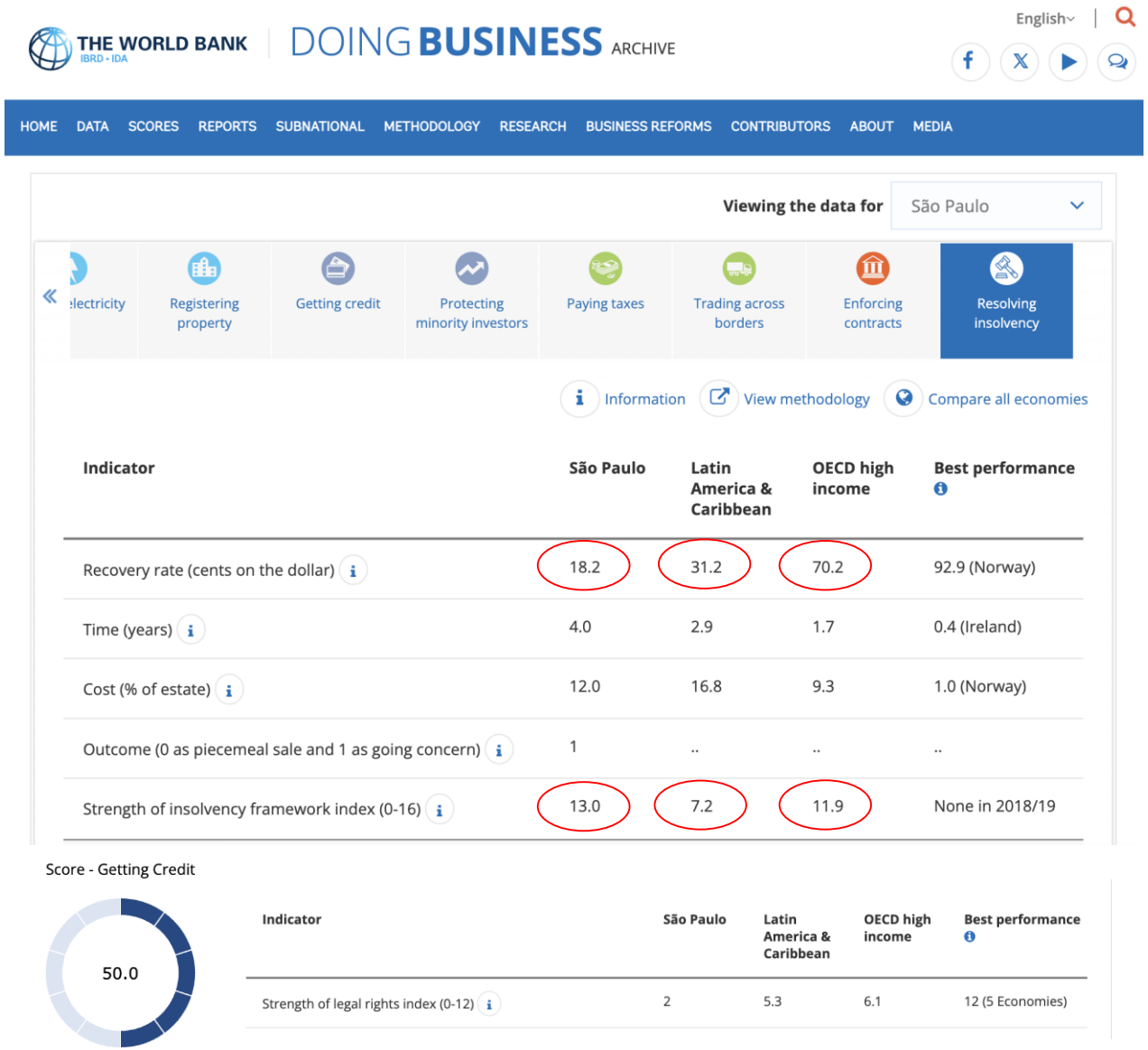
	Jan	Fev	Mar	Abr	Mai	Jun	Jul	Ago	Set	Out	Nov	Dez
2022	67	55	88	65	58	57	56	74	70	107	59	77
2023	92	103	94	93	119	92	102	135	136	162	175	102

Fonte: Serasa Experian

(<https://archive.doingbusiness.org/en/data/exploreeconomies/brazil#DB_ri>)

Brazilian Experience: The Sickness

- ✓ Brazilian practicioners, authors and policy makers frequently affirm that the BBL does not fully protect interests of creditors
- ✓ High demand: how to solve the creditor problem in Brazil?
  - ***Piecemeal approach***: policymakers started adding "advantages" for creditors and remedies to deal with common issues of the proceeding



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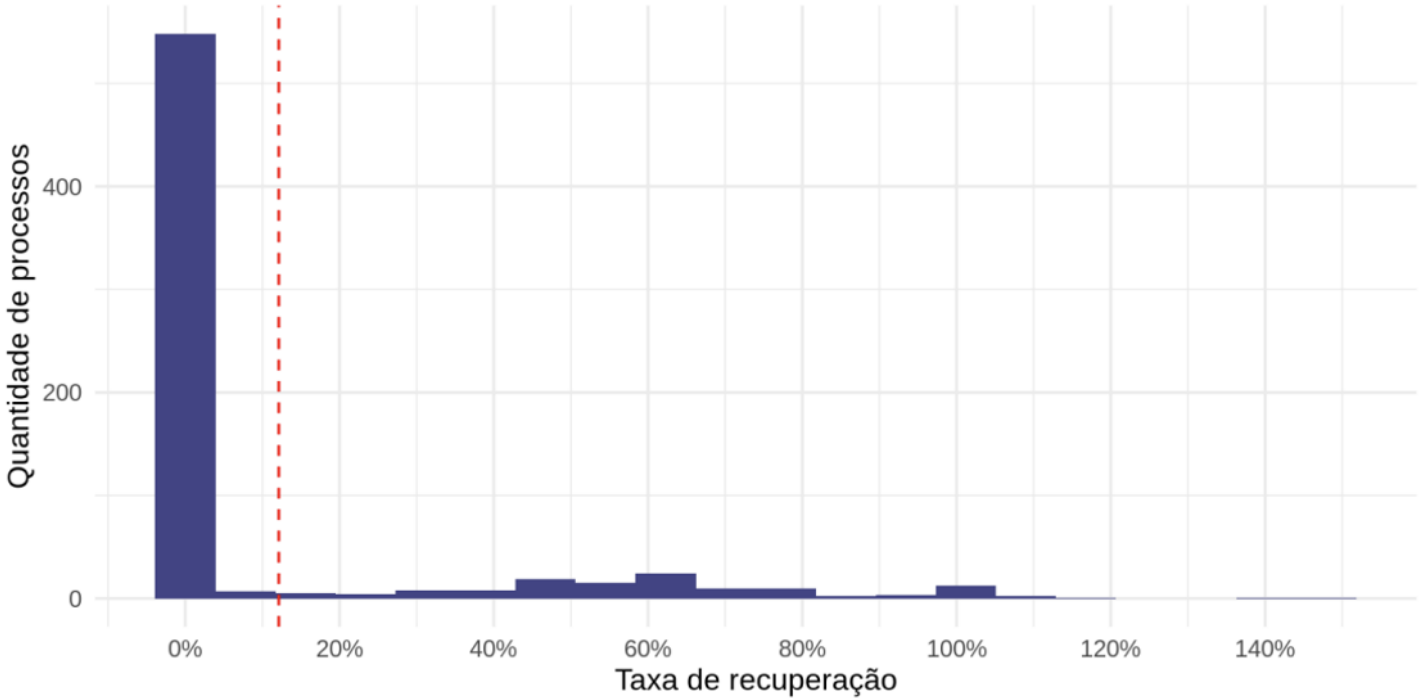
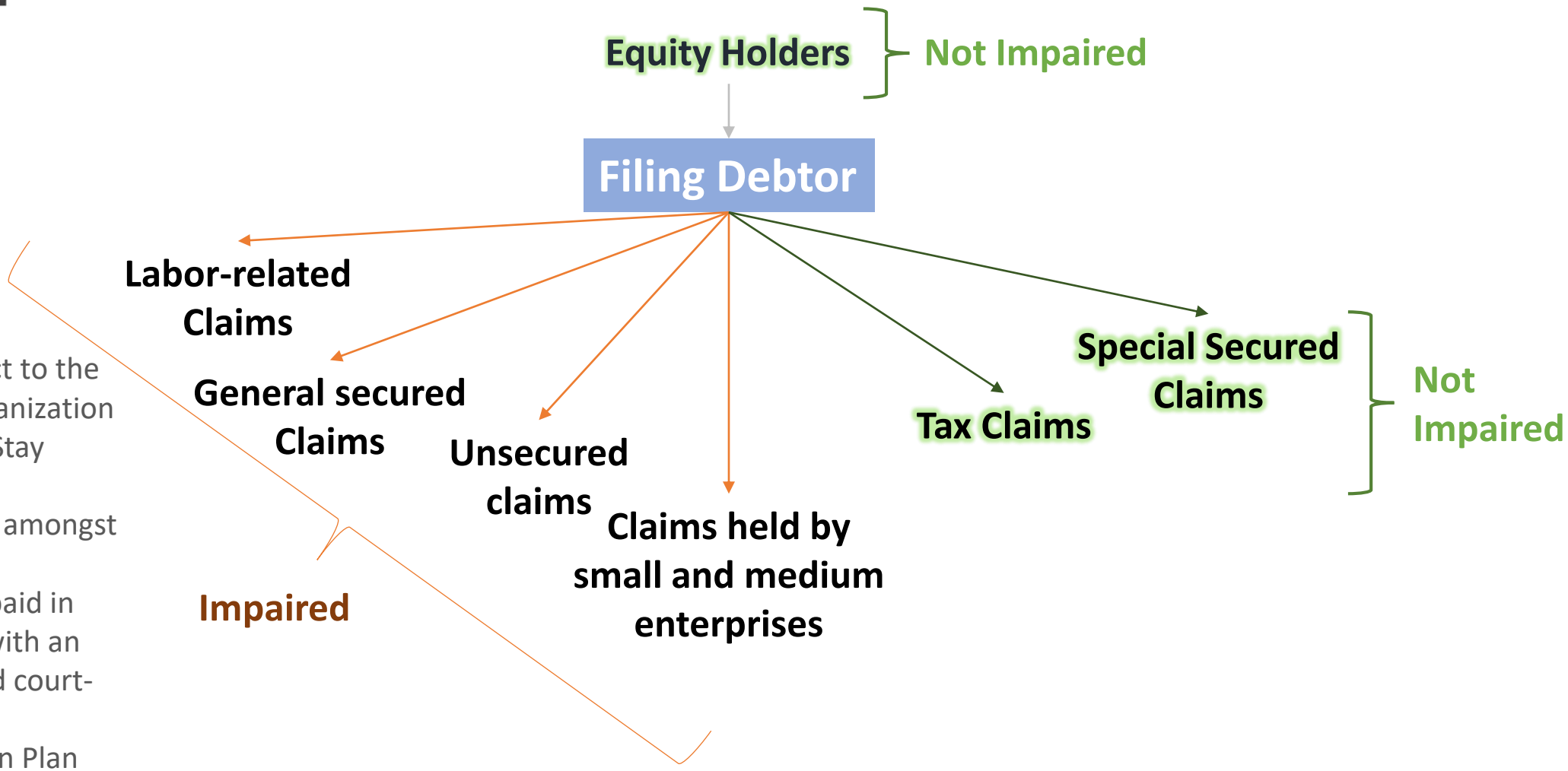


https://abj.org.br/pesquisas/3a-fase-observatorio-da-insolvencia/

How Creditors / Debtors / Shareholders are treated in RJs



- Claims subject to the judicial reorganization proceeding (Stay Period)
- No Hierarchy amongst classes
- Can only be paid in accordance with an approved and court-confirmed reorganization Plan

How Creditors / Debtors / Shareholders are treated in RJs

SUBJECT CREDITORS HAVE THE RIGHT TO DECIDE THE FUTURE OF THE COMPANY

- The confirmation of the Plan depend on the approval of each class of claim (regularly or cram-down)

- Subject creditors are the only ones entitled to vote
  - Premise is that mostly sophisticated entities can analyze the Plan and decide the future of the Company
  - Case Law: Brazilian Courts cannot analyze the economic merits of a Plan. Only the creditors can have an opinion over this

How Creditors / Debtors / Shareholders are treated in RJs

PRACTICAL PROBLEMS: VALUE DISTRIBUTION INCENTIVES OTHER BEHAVIOR

- Creditors might receive more if compared to a liquidation: different order of claims x no order of claims
- Creditors can have different interest: debt market in Brazil is utterly concentrated. Most times, the same 5 banks are the main creditors of most of the debtors
    - Such sophisticated banks often carry fiduciary assignments or collaterals against the shareholder or any of its assets
    - The bargain might involve the capture of value out of the judicial restructuring, and using the RJ as a tool to approve a plan and reduce Company's leverage
    - Few incentives to reject a plan or liquidate – as in the liquidation, an order of priority involving all creditors indeed exists

How Creditors / Debtors / Shareholders are treated in RJs

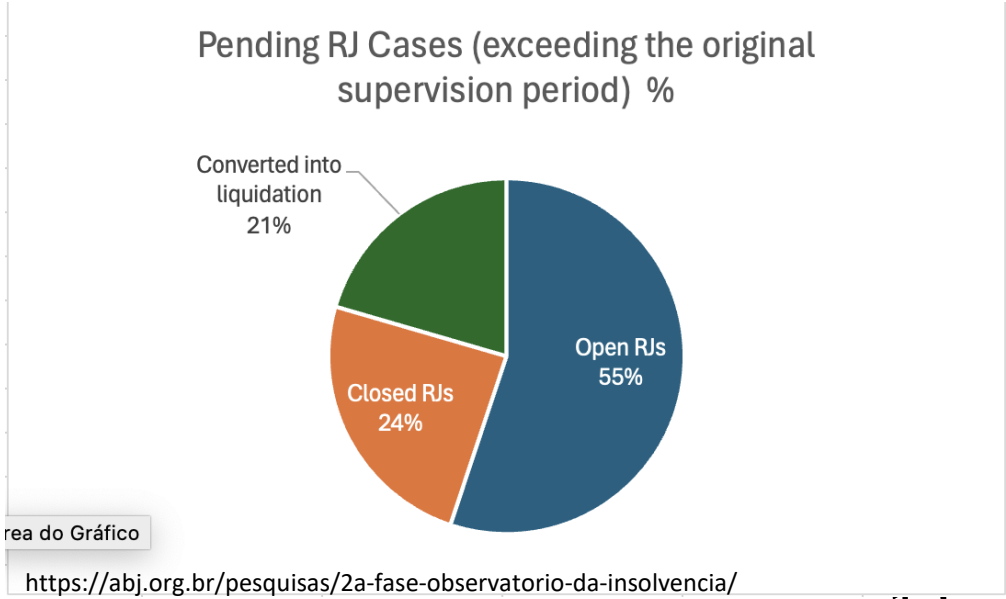
Equity Holders } **Not Impaired**

Filing Debtor

- Controlling shareholder will not loose its property over the debtor.
- Commonly, controlling shareholder proposes the Plan
- Structure does not create incentives for filing before it is too late (no specific filing requirements for officers)

- *In theory*: creditors full authority to approve or reject plans should balance with the power given to the shareholder to file for RJ and not be dragged into one

- However…
  With a poor liquidation environment, the structure led to as a lengthy proceedings that favor debtors not paying its obligations (further undermining its liquidation value)



https://abj.org.br/pesquisas/2a-fase-observatorio-da-insolvencia/

The remedy: a Creditors' Plan

- ✓ U.S. Inspired remedy
- ✓ Legislator claimed this would favor continuity of the business (as creditors could approve their own Plan avoiding liquidating the company)

THE FRAMEWORK (art. 56)

- Only Debtors can propose the plan during first part of the RJ proceeding
- If Creditors reject the plan (or if Debtors fail to have a plan approved within 180 days from filing), Creditors are entitled to present an alternative Plan **provided that** at least 25% of all subject claims /or/ at least 35% of all claims present at the creditors' meeting support this initiative
- Alternative Plan should be presented within 30 days and should be approved by regular quoruns (majorities in each class)

The remedy: a Creditors' Plan

- ✓ U.S. Inspired remedy
- ✓ Legislator claimed this would favor continuity of the business (as creditors could approve their own Plan avoiding liquidating the company)

LIMITATIONS TO THE PLAN'S CONTENT

- Cannot attribute new obligations to Debtors' shareholders that are not contemplated under the Law or agreements previously executed
- Personal guarantees of individual shareholders in the benefit of creditors proposing or approving the Plan shall be released
- Cannot impose to shareholders higher burden (*sacrifício maior*) if compared to the liquidation proceeding
- Can convert claims into equity, allowing shareholders withdrawal rights

Side effects: Other Creditors' Issues

Creditors proposing the Plan **<u>are not</u>** forbidden from voting

- BBL deals privately with the assessment of the economic merits of the Plan
    - There are no rules preventing different treatment for creditors proposing the Plan
    - Creditors can cram down a Plan, with no priority rules, and distribute value differently

Creditors that influence directly the Company's management without being considered shareholders

- In general, Brazilian Law is not used to non-equity controlling parties. Case Law / Law should include parameters for doing so, to avoid legal uncertainty

Side effects: Equity Issues

Shareholders **<u>are not</u>** entitled to vote as equity

- Votes occur under 4 rigid classes of claims (labor, general secured, unsecured and small enterprises). No equity class

- Even unclear whether shareholders' credits for money lent to the Company would be entitled to vote
  - BBL prevents those from voting on normal Debtor plans

Different from U.S. inspiration, in which the equity can constitute one or more classes and vote with a higher quorum + Cram down rules

- Creditors remain entitled to decide whether a Plan can be approved
  - Court should not be involved in the economic merits of the Plan

- There are no Absolute or Relative Priority rules in Brazil
  - Incentives for different value distribution remain / are increased

Different from U.S. inspiration, in which the APR and Best interest of creditors' test are considered by the Court as a requirement for approval

Side effects: Litigation and threats

Creditors x Creditors | Shareholders x Creditors:

- Claims for conflict for votes from creditors that proposed the Plan

- Claims to prevent any restructuring measure that involves the equity ownership without shareholder approval (as Corporations' Law was not altered)

- Claims for lender liability: Creditors proposing the Plan would be responsible in case the Plan / Company ultimately failed as they have led and relevantly influenced the Company in a path that might not be suitable for its success

So far, side effects are stronger than the medicine

- x No known RJ Creditors' Plan have been approved
- x Litigations related to it led RJs to become even lengthier (+ 3 Years)
- x Brazilian banks flee from liability claims
- x Creditors that tried to propose Plans were caught in litigation and ultimately settled
- x Liquidation statistics have not changed, and **Law is being once again amended**

Side effects: Litigation and threats

Lender Liability

Should a creditor be held liable for a RJ Plan that was not successful /OR/ for the failure of the Company?

Yes

x If Plan submitted led to preferential treatment for the creditor proposing it

x If creditor used the proceeding as a tool to change value distribution and benefit itself in a future liquidation

x If creditors exerted influence over the Company to exert control and lead the company to commit illegal acts

x If creditor led the Company to perform against its best interests and to benefit itself

- Limitations are essential to provide legal certainty
- Will benefit Creditors in good faith that want to propose viable Plans and mindful of other creditors' rights

Final Remarks

This attempt serves as a warning to piece-meal policymaking

- To partially address a concern importing a mechanism info a legal framework not fully adapted to it can jeopardize the system itself
- To include provisions that create more risks than benefits undermine the BBL system
- From deep examination, several other issues should have been addressed for creditors to safely use this tool
- While the BBL does not address the liquidation issue properly, creditors' incentive to reject plans and prevent lengthy restructurings are minimized

Adrian WALTERS and Sarah PATERSON
Chicago-Kent Law School and LSE

Jassmine GIRGIS and Sulette LOMBARD
University of Calgary and University of South Australia

Ana Elisa LAQUIMIA
University of São Paulo

#insolvency #restructuring #5thsymposium

@walters_adrian; @HenkelProfessor; @LCoordes;
@YseultMarique @eugevaccari86

MSMEs in Financial Distress (round table)

Dr. Leonardo V P de OLIVEIRA

Royal Holloway, University of London

Round Table on MSMEs in Financial Distress

- What are MSE, SME and MSME?

Round Table on MSMEs in Financial Distress

How relevant are MSEs in the economy of both developed and emerging economies? Is there a case for special rules applicable only to them?

Jason HARRIS

University of Sydney

MSE Insolvency: Do they need their own regime?

- MSEs are the bulk of registered and *unregistered* businesses in all jurisdictions
  - Key driver of employment and, in some areas, innovation and entrepreneurship
- MSEs have different needs from medium, large and mega businesses
  - Low asset base, difficulties in obtaining external finance
    - Problems accessing the insolvency system: Too poor to go broke?
  - Lack of independent equity in the business (owner/manager is the value)
  - Strong personal ties (a job for the owner) and overlapping persona/business finance
  - Lack of management skills, and problems sourcing appropriate and cost effective advice
- Do we need a specific MSE procedure: YES
  - (examples) Australia: Small business restructuring; India: PPIRP; US: Subchapter V

Round Table on MSMEs in Financial Distress

What are the specific challenges faced by MSEs in South Africa?

Princess NCUBE

University of Pretoria

Round Table on MSMEs in Financial Distress

What are the rules applicable to MSEs in financial distress in the EU and in some of the countries considered in your study?

Giuliana SCOGNAMIGLIO and Filippo VIOLA

Università di Roma “La Sapienza”

(i) Early warning (ii) Checklist (iii) Consent to the plan

- Our theme is enterprises in financial distress (which is obviously not the same as enterprises in insolvency), our point of reference is Directive (EU) 2019/1023 on preventive restructuring frameworks.
- One of the aims of this directive is to provide support to SMEs in restructuring at low cost (Directive, Recital 17).
- Tools to achieve this goal:
- (i) **early warning tools** (available even in the case of a mere probability of insolvency); information about them easily accessible online and presented in a user-friendly manner (Directive, Art. 3.4); Germany, Para. 101 STARUG; Spain, Art. 690 TRLC, notice of commencement of negotiations with creditors; Italy, art. 3 of the Crisis and Insolvency Code, entered into force on 15 July 2022; France, Art. L611-1 ff., on "*la prevention dès difficultés des èntreprises*";
- (ii) **comprehensive check list for restructuring plans** (including practical guidelines on how the restructuring plan has to be drafted under national law) adapted to the needs of SMEs (Directive, Art. 8.2): Italy, Art. 13.2 of the Crisis and Insolvency Code; Germany, para. 16 STARUG. The checklist is made available on the institutional website of each chamber of commerce (Italy) or the Ministry of Justice (Germany);
- (iii) When the debtor is an SME, its **consent is always required** (Directive, Art. 4.8) either at the time of the introduction of the procedure, when an initiative by third parties is envisaged, or in the case of approval of non-consensual plans (Italy: the debtor's consent is always required, although the role of the shareholders is highly debated; Spain: debtor's consent always required in SMES and Microenterprises; on the contrary, in large enterprises plan's confirmation can occur without the debtor's consent, but not in the case of mere probability of insolvency);

(iv) Class formation
(v) Cross class cram down

(iv) **Possible exemption** of SMEs from class formation requirement (Directive, art. 9.4 and recital 45):

4.1. In Italy, formation of classes always compulsory in composition with creditors enabling the continuity of the business (Art. 85 para. 3 CIC) and as regards shareholders in listed companies and in case of direct impact on their rights: therefore, no difference between large enterprises and SMEs.

4.2. No difference in German law as well.

4.3. In Spanish law, special rules for microenterprises.

4.4. In French law, possible exemption from class formation provided for (unless expressly requested by the debtor) with regard to the *sauvegarde* procedure for companies that do not reach certain size thresholds, established by decree of the *Conseil d'Etat*, having regard to turnover and the number of employees.

- (v) Possibility of providing for **alternative methods to the cross class cram down to prevent shareholder obstructionism**. When choosing these alternative methods, the Directive requires that account be taken of whether the debtor is an SME or a large enterprise (Directive, art. 12.3):
- 5.1. In Italy cross class cram down allowed (the plan is approved with the consent of only one class of impaired creditors) regardless of the nature and size of the debtor. The dissent of the class or classes of shareholders in fact counts for little if there is no other class below them. If the shareholders vote against the plan, prompting the judge's scrutiny, the judge will have to verify that the distribution rules have been complied with in the relations between shareholders and creditors or in the relations between classes of shareholders if there are more than one. In this case, the plan will be confirmed.
- 5.2. In German law (para. 28.2), shareholders may retain their shares if their cooperation in the company's continuation programme appears indispensable, due to circumstances related to their person, in order to achieve the '*Planwert*' (restructuring value) and they undertake to this cooperation.
- 5.3. In France, in the *sauvegarde* procedure, applicable to companies above a certain size threshold (and only on a voluntary basis to companies below the threshold), the cross-class cram down requires the debtor's consent; if one or more classes of capital holders have been formed, and these have voted against the approval of the plan, approval by the court is possible (a) if the company has more than 150 employees and a turnover of more than EUR 20 million (b) it can reasonably be assumed, based on the valuation that has been made of the going concern, that these capital holders would not be entitled to any payment.

Round Table on MSMEs in Financial Distress

What are the peculiarities of the farming sector?

What are the key findings of your comparative study on farming insolvencies?

Oriana CASASOLA

University of Leeds

What Are The Peculiarities of The Farming Sector?

- Food production
- Market with inelastic demand
- Exposed to sector-specific risks
- Greatly affected by Brexit, COVID-19 and Russo-Ukrainian war
- Traditionally low numbers of formal bankruptcy/insolvency
- Recently sharp increase of numbers of formal bankruptcy/insolvency

What Are The Key Findings of Your Study on Farming Insolvencies?

- The farming sector has a great variety of business forms
- The major creditors are banks, hire purchase agreements and supplies of the three F's
- Farmers are not the common businessman

From the comparison with U.S.A. and Australia: Mandatory Farm Debt Mediation could be a solution

Round Table on MSMEs in Financial Distress

What would an ideal MSE-focused insolvency framework look like?

Jason HARRIS

University of Sydney

What is an ideal MSE-focused insolvency framework?

Law reforms

- The value of on-ramps and off-ramps
- Fast track options
- Debtor-in-possession
- Interim moratorium
- Design around the needs of the MSE population
  - Consider MSE procedure for both corporate and non-corporate businesses

Other measures

- Improve information flow and encourage early action
- Change the narrative around business failure (broad consultation on reforms)
- Improve law enforcement
- Get buy-in from government authorities (eg Revenue)

Round Table on MSMEs in Financial Distress

In your paper, you compared the SA with the UK approach. Why did you choose the UK, and what lessons can we learn from this comparison?

Princess NCUBE

University of Pretoria

Round Table on MSMEs in Financial Distress

You also conducted a comparative study, this time between the Italian and the U.S. framework. What are the findings of your study?

Giuliana SCOGNAMIGLIO and Filippo VIOLA

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Restructuring value distribution

USA

Different cram-down standards for unsecured creditors:

- Small Businesses (total amount of debt not exceeding $ 7,500,000): Disposable income method. Possible retention of shares by shareholders even if unsecured creditors not accepting the plan are not paid in full
- Other Businesses: APR. Shareholders are wiped out if unsecured creditors not accepting the plan are not paid in full

Italy

A single cram-down standard applicable to all firms:

- EU RPR + New value exception (*but* "sweat equity" is relevant for NVE purposes only in small firms)

Procedural aspects

USA

Simplified governance, disclosure and confirmation for small firms compared to ordinary Chapter 11:

- No creditors' committee is contemplated
- Simplified disclosure requirements (brief history of the business operations, liquidation analysis and projections with respect to the ability of the debtor to make payments under the plan)
- In non-consensual plans there is no requirement that an impaired class accept the plan

Italy

There are no specific rules for small businesses (and in non-consensual plans an impaired class must always accept the plan)

Round Table on MSMEs in Financial Distress

- What is, in your opinion, the most effective tool to facilitate MSE restructuring?

Jason HARRIS

University of Sidney

Princess NCUBE

University of Pretoria

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