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Restructuring and insolvency – opportunities for reform in Europe

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Abstract

European insolvency frameworks have improved considerably over recent years. However, they still lag best practice in terms of both creditor recovery and the ability to restructure complex firms. Moreover, they tend to push restructuring out of court or to foreign jurisdictions and potentially generate “zombie” firms.

In this ASC Insight, we argue that insolvency frameworks across the EU could be improved further through additional reforms, leading to better outcomes for insolvent firms and enhanced financial stability. Such reforms could provide a significant boost to the European capital markets union and counter a current trend of relying on non-European jurisdictions to resolve insolvency.

An effective insolvency framework must aim to restructure viable firms to preserve their going-concern value, while also liquidating non-viable firms to free up resources for more productive uses. Key components of an effective regime are the capacity to make optimal decisions regarding liquidation or continuation, the protection of operational value through measures such as automatic stays and the flexible handling of contractual obligations, and recourse to cramdown mechanisms to avoid inefficient hold-up by individual creditors. We detail potential areas for reform that would enhance these aspects of European insolvency frameworks.

To address these opportunities for reform, we propose the introduction of an EU-wide opt-in insolvency framework, building on the concept of a “28th regime” at the European level (see European Commission, 2025). Given the significant challenges associated with harmonising insolvency laws across diverse jurisdictions and the complexities of implementation across many countries, a new EU-wide system could significantly accelerate reforms towards an effective insolvency framework. Operating alongside existing national regimes, this system would offer a uniform, predictable and efficient restructuring process for firms that elect to participate while allowing others to retain their current national procedures. The proposed framework would improve creditor recoveries, reduce unnecessary losses and strengthen EU capital markets. We view such a reform as essential for addressing the EU’s substantial investment needs, including those related to infrastructure, defence and the green transition.

1 Introduction

Efficient insolvency frameworks are key for promoting economic growth and financial stability. The importance of such regimes is reflected in ongoing reform and harmonisation efforts following both the 2019 EU Directive and national initiatives.[1] However, challenges remain. Couthino et al (2023) point to significant differences in the efficiency of insolvency frameworks across EU member countries.[2] According to the World Bank's Doing Business survey, the average EU score for resolving insolvency is 70.2 out of 100. This score is lower than the average for high-income OECD countries (74.9), for example, or the scores for Japan (90), Norway (85.4) and the United States (90.5).[3] While some individual EU countries do better (e.g. Belgium, Denmark, Finland, Germany or the Netherlands), on average European insolvency frameworks fall short of global best practice in terms of outcomes such as speed, transparency, and value recovery.

For large firms with complex debt structures, multinational operations, many corporate subsidiaries and intangible assets, liquidation is typically an inefficient outcome. Such firms pose the greatest challenge for European insolvency frameworks. It is interesting to note that some of the largest European insolvencies (e.g. Swissair in 2002 and Parmalat in 2003) have been resolved through liquidation. Even more striking is the fact that, since those cases, several large European firms have opted to use Chapter 11 of the US Bankruptcy Code to restructure instead of filing for bankruptcy in Europe.[4]

Improving insolvency frameworks in Europe is an important step in driving forward the EU's capital markets union (CMU). The EU financial system relies disproportionately on bank credit. However, the EU's significant future investment needs, including investments in infrastructure, defence and the green transition, cannot be met by banks alone. We believe that market-based financing options that could fill this gap could be accelerated by improvements to European insolvency regimes. While banks find it relatively easy to renegotiate debt out of court, bond markets rely on predictable and efficient insolvency frameworks. Without such frameworks, the CMU will remain incomplete. Improved European insolvency frameworks would provide a boost for the CMU and help facilitate growth in EU bond markets, bank lending and non-bank private credit to help meet European firms' financing needs.

Worldwide, insolvency frameworks were on high alert during the COVID-19 pandemic. There were concerns that the temporary shutdown of the economy would lead to a potentially large increase in insolvencies across the EU (see, for example, Becker and Oehmke, 2021, and ESRB, 2021a). Worst-case scenarios foresaw a wave of bankruptcies that could overwhelm European insolvency

1 See European Union (2019).

2 See Coutinho et al. (2023) for a detailed discussion of cross-country differences in "resolving insolvency" scores.

3 These data refer to the 2019 survey, accessed in October 2024 at the **Resolving Insolvency** page on the World Bank's Doing Business website. The Doing Business survey has been discontinued as a result of criticism on how the values for some countries were compiled. However, the criticism that led to its discontinuation is not related to the countries and measures referred to here. A replacement survey from the World Bank, starting in 2024, covers, for the time being, a smaller set of countries.

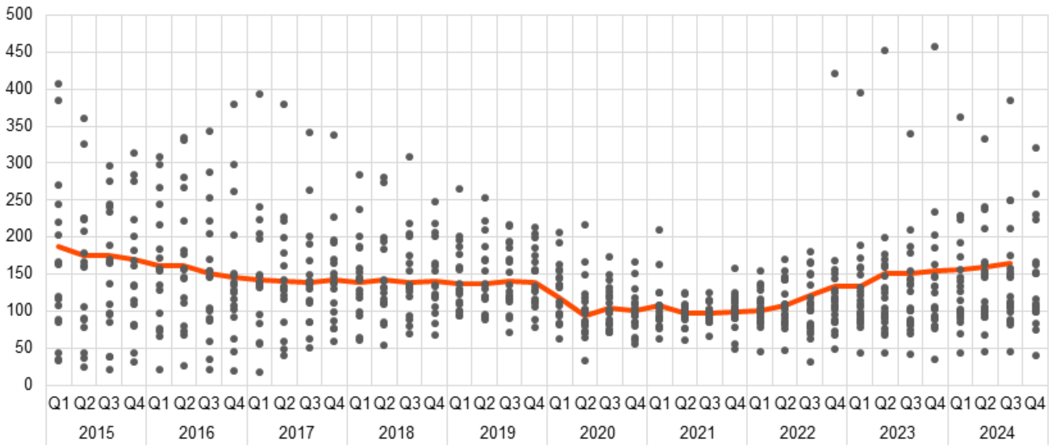
4 Examples include Scandinavian Airlines (filing in 2022, based in Denmark and Sweden), LyondellBasell (2009, Netherlands), Intelsat (2020, Luxembourg) and Northvolt (2024, Sweden). Northvolt also filed for insolvency in Sweden in March 2025. Several large Latin American firms have also used the US Bankruptcy Code, including LATAM Airlines Group and Grupo Aeroméxico.

frameworks, potentially leading to the inefficient liquidation of many economically viable businesses. Thanks to decisive policy action and a successful shift to remote working and technology, the feared wave of insolvencies did not materialise.[5]

More recently insolvencies have started to increase across the EU (as well as in the United States), and the number of bankruptcy filings are now comparable to the pre-pandemic period (Chart 1).[6] Among other factors, this reflects higher interest rates, increased energy costs and insolvencies delayed but not prevented by now-withdrawn pandemic-era support measures.

Chart 1
EU business bankruptcies

(index: 100 = 2021)



Source: Eurostat.
Notes: The red line indicates total EU business bankruptcies. Grey dots indicate individual EU countries. Data for Cyprus, Hungary, Malta and Spain is not included.

While the current outlook is certainly not alarming, economic dynamism, resilience to future shocks and the EU's significant future investment needs all require insolvency frameworks that can achieve the twin goals of restructuring viable firms (to preserve going-concern value) and liquidating non-viable firms (so that assets can be freed up and redeployed elsewhere in the economy). Moreover, given that restructuring and liquidation generally lead to financial losses, these two goals should be achieved while maintaining financial stability.

With these goals in mind, this note discusses opportunities to reform insolvency frameworks in Europe. In Chapter 2, we explain the value of a well-functioning insolvency framework. Chapter 3 briefly discusses past and ongoing EU insolvency reforms. In Chapter 4, we point to some possible areas of reform for the European insolvency framework, with a focus on practical reforms that could be implemented relatively easily within existing structures and those that can promote financial

5 Among other measures, the policy response in the EU included moratoria, public loans and guarantees, grants and tax relief (see ESRB, 2021b, 2021c).

6 These data on bankruptcies do not cover restructuring procedures outside of bankruptcy, creating a serious information gap at the EU level. Collecting data on all insolvency procedures, including restructuring outside of bankruptcy, would be of great value.

stability and the CMU. Chapter 5 proposes a concrete reform, the "EU-wide opt-in insolvency framework". This proposal recognises that complete harmonisation of national insolvency laws across EU countries is likely to be neither feasible nor necessarily desirable. To capture the benefits of harmonisation and essential features of a well-functioning insolvency regime, we therefore propose the creation of an EU-wide insolvency framework that firms can opt into. This would allow firms that benefit from a uniform EU-wide system to reap those benefits, while still allowing others to remain under their current national frameworks. Moreover, because an EU-wide framework would be created from scratch, it would require no (or minimal) changes to national insolvency frameworks. Chapter 6 concludes. Appendix A contains a summary of current insolvency trends in Europe and elsewhere.

2 The value of a well-functioning insolvency framework

An efficient insolvency system has two main goals. First, it should facilitate the restructuring of viable firms. And second, it should enable non-viable firms to be liquidated as efficiently as possible (see, for example, Becker and Oehmke, 2021).

Efficient insolvency frameworks are critical to creditors and other stakeholders of insolvent firms, but also to the financial system and the wider economy. For example, when creditors expect high and predictable recovery, they are more likely to extend credit. When viable but insolvent firms are restructured rather than liquidated, their going-concern value is protected, and economic dynamism increases. Conversely, when non-viable firms are kept alive, labour, capital and other resources are locked up in low-productivity activities (see Caballero et al., 2008). Inefficient liquidation of viable firms destroys their going-concern value and creates negative spillovers on other firms and other stakeholders (see Bernstein et al., 2019, and Graham et al., 2023).

Many European countries have insolvency frameworks that tend to liquidate firms or realise low values (see Djankov et al., 2008). This tendency to liquidate stands in contrast to Chapter 11 of the US Bankruptcy Code, which aims to restructure viable firms, with the option of liquidating non-viable firms under Chapter 7. With a long track record of successful restructurings even after serious economic downturns, Chapter 11 has become the best-established insolvency framework globally (see Djankov et al., 2008, and Gilson, 2012). The observation that, in recent years, no large firm (with a complex balance sheet, intangible assets and multinational operations) has restructured under any of the European insolvency frameworks suggests that these are not (yet) fit to deal with complex restructurings.

Below, we highlight three areas where restructuring and insolvency are important for the European financial system and economy: the capital markets union, zombification and financial stability.

2.1 The capital markets union

A well-functioning insolvency framework is key to developing a successful European capital markets union. Ineffective insolvency frameworks can push borrowers and lenders to use informal restructuring options (see Strömberg, 2000). This discourages the use of non-bank debt (such as corporate bonds) because banks have information and bargaining advantages out of court (see Becker and Josephson, 2016). Consequently, the development of non-bank debt markets is directly linked to having a well-functioning insolvency framework. The United States offers a prime example, where high-yield bonds, leveraged loans and private credit flourish in part thanks to high and predictable recovery for creditors under Chapter 11. The overarching purpose of insolvency frameworks is to allow financial markets to operate efficiently and predictably, thereby supporting a healthy private sector. The Draghi Report (2024) also points out the importance of insolvency for start-ups and scale-ups − “harmonised legislation concerning corporate law and insolvency” (p. 29) − in allowing European firms to scale up across international borders.

2.2 Zombification

"Zombie lending" is a form of bank lending to otherwise insolvent or non-viable firms (see Caballero et al., 2008, and Acharya et al., 2022). Caballero et al. (2008) introduced the term in the context of the Japanese economy, where banks were seen to prefer hiding problematic borrowers by extending new credit, even if eventual losses were likely and the new loans had a negative net present value from the perspective of the bank. This reflected agency problems (e.g. managers wanting to report good numbers to their superiors) rather than representing a value-maximising strategy. Additionally, a bank may rationally prefer to support weak borrowers to avoid dealing with inefficient insolvency frameworks. Poor insolvency rules encourage this kind of zombie lending (see Becker and Ivashina, 2022). Whatever the underlying mechanism, zombie lending misallocates credit away from new firms and firms with growth opportunities towards old firms with existing bank debt. This can reduce competition in product markets where supported firms benefit from a subsidised cost of capital, create excess supply, reduce economic dynamism and slow economic growth (see Caballero et al., 2008, and Acharya et al., 2024).

2.3 Financial stability

Restructuring and insolvency are important for financial stability in several ways. A failed firm can impose costs on its lenders as well as on other firms (see Schivardi et al., 2022, and Bernstein et al., 2019). An efficient insolvency framework will minimise but not eliminate total losses. Successful restructuring may require that lenders absorb some losses, albeit typically smaller than in the case of liquidation. To facilitate the restructuring of distressed firms with positive going-concern value, it is therefore important that lenders, including banks, can absorb losses, so that efficient restructuring does not threaten financial stability. Cost spillovers to other firms are also important for financial stability, since the systemic impact of widespread bankruptcies is potentially much larger when firms affect each other. Gilson (2012) documents how important Chapter 11 was for the US economic recovery after the financial crisis in 2008.

3 EU insolvency reforms

The European Banking Authority (EBA) reports that, including SMEs and larger borrowers, the normal recovery for corporate bank loans is in the 35-50% range, based on 338,000 loans that entered insolvency proceedings (see European Banking Authority, 2020).[7] This figure contrasts with European recovery rates for first lien secured debt (including bonds) of around 60% (see S&P, 2025). Recovery was higher for loans secured by real estate, loans issued in jurisdictions where legal rules favour debt enforcement, loans issued by institutions where credit committees had influence on restructuring proceedings, loans in countries where government claims (including tax and pension schemes) do not receive special treatment and loans in countries where pre-pack options are available. These metrics are not necessarily indicative of overall recovery because non-bank stakeholders were not included in the EBA analysis. For example, out-of-court enforcement may benefit banks at the expense of more frequent liquidation of viable firms. Swift liquidation tends to favour senior creditors (most bank debt is senior) over other stakeholders. The EBA report unequivocally shows that recovery is low in Europe (since even senior creditors often have low recovery) and that legal rules are important for economic outcomes.

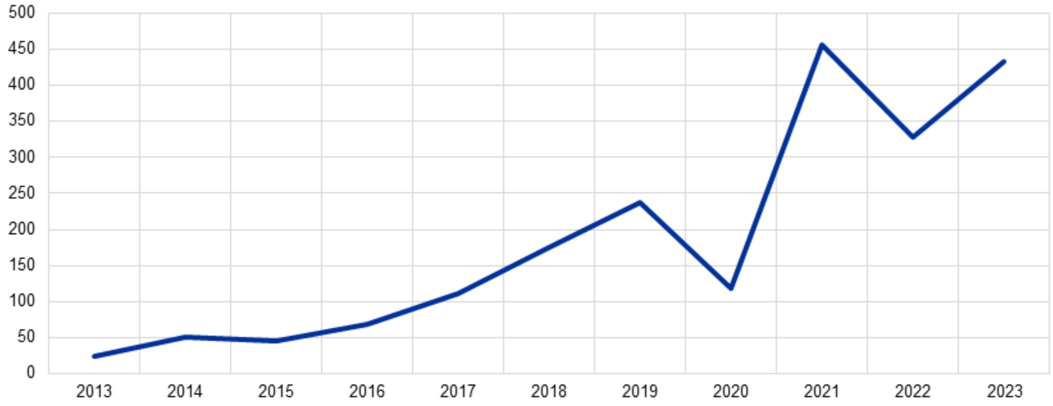
A clear sign that the European insolvency framework is not working as well as it might is that several large European firms have turned to the US system in recent years. Chart 2 shows that the number of non-US firms filing in the United States has been rising steadily.[8] This is not in itself a problem (indeed, the option has probably protected value in these firms). Realistically, though, the option to use the US insolvency framework is only viable for the largest European firms, and the local system has no substitutes for firms without US operations and below a certain size.

7 Because these numbers are based on data up to December 2018, they do not reflect potential effects of EU Directive 2019/1023 on preventive restructuring.

8 The data are not disaggregated by origin country. It is therefore possible that part of this increase is driven by non-European firms.

Chart 2
Number of non-US bankruptcy filings in the United States

(number)



Source: Report F-5A, Administrative Office of the U.S. Courts.

The EU has taken up the challenge of improving and harmonising insolvency law across EU Member States through a series of directives.[9] The EU can bring a greater depth of legal and economic insight to the design of reforms than individual countries, and the directives have significantly accelerated the improvement of European insolvency frameworks. Thanks to EU reforms in this area, the closer integration of European credit markets is becoming a more realistic possibility. However, there is still some ground to cover to develop the capacity to efficiently restructure larger, more complex insolvent firms in the EU. Among the challenges faced by the EU are insufficient harmonisation across countries, poor timing of restructuring processes and insufficient expertise in and around courts handling insolvency.

The EU is continuing to pursue its reform agenda. The European Parliament introduced the additional goal of "increasing legal certainty for cross-border investments by making national insolvency proceedings more efficient and effective" in 2020.[10] "In 2022, the European Parliament's Committee on Legal Affairs continued its work on the topic on the basis of a "proposal for a directive aimed at enhance and harmonising insolvency law in the EU" from the European Commission." And the Commission has proposed harmonising several areas of insolvency law, including avoidance actions, tracing assets (including across borders), allowing pre-packaged procedures and standardising directors' duties to initiate insolvency procedures.[11]

9 A directive is a legislative act that sets out requirements for Member States. It is up to the individual countries to devise their own laws on how to reach these goals. In insolvency law, differences in legal philosophy (e.g. civil law vs common law) and specifically in corporate and contract law would make it difficult to use identical legal instruments across the EU. See, for example, Wessels et al. (2020).

10 See European Parliament resolution of 8 October 2020 on further development of the Capital Markets Union (CMU): improving access to capital market finance, in particular by SMEs, and further enabling retail investor participation (2020/2036(INI)).

11 See the Proposal for a Directive of the European Parliament and of the Council on harmonising certain aspects of insolvency law, COM/2022/702.

Ongoing EU reforms are vital to creating an effective capital markets union, reducing unnecessary losses for creditors and other stakeholders and creating a vibrant entrepreneurial economy. Letta (2024) argues that national reforms are insufficient for achieving an efficient restructuring regime and suggests EU-wide reforms are key. In the next chapter, we discuss some of the key components of effective insolvency frameworks, with a particular eye to possible targets for current and future EU reforms.

4 Key components of effective insolvency frameworks

This chapter highlights some of the key components of effective insolvency frameworks. While some of these components are present in current national insolvency frameworks and others have been addressed by recent EU reforms, significant additional opportunities for reform remain.

4.1 Optimal liquidation/continuation decisions

The key to success for an insolvency framework is its ability to restructure viable firms and at the same time liquidate non-viable firms (the “twin goals” mentioned in the introduction). A firm is considered insolvent when it cannot meet all its financial obligations, but it may still be worth more as a going concern than if liquidated. In this case, the value-maximising choice is to continue commercial operations in some form. A system which manages to handle each scenario correctly can create significant economic value.

Under the US Bankruptcy Code, liquidations are handled under Chapter 7, while Chapter 11 provides a mechanism to restructure an insolvent firm as a going concern. In 2023 there were 10,185 Chapter 7 cases and 6,473 Chapter 11 cases for businesses in the United States (U.S, Courts 2024), which implies that more US bankruptcies lead to liquidation than restructuring. When it was first introduced, Chapter 11 was considered debtor friendly because processes continued for too long with existing management in place and junior claimants (such as equity) sometimes received payouts in conflict with priority rules (see Bebchuk and Chang, 1992). Such “management control” may have led to insufficient liquidation in the early days of Chapter 11.[12] Over time, the mechanisms giving shareholders and managers control were reversed or weakened through legal precedents, several reforms of Chapter 11 and new legal tactics developed by creditors, who now exert significant influence (see Ayotte and Morrison, 2009, and Ivashina et al., 2016). Company management cannot now control the process in the way that was possible in the early years of Chapter 11.

Traditionally, bankruptcy proceedings in most EU countries would lead to the liquidation of insolvent firms. The 2019 EU Insolvency Directive[13] pushed restructuring towards proceedings that begin early (called “pre-insolvency”). By commencing insolvency proceedings before firms are insolvent, this legal approach has avoided direct conflict with bankruptcy law, which in most countries requires a liquidating bankruptcy process to commence immediately if a firm is insolvent. A major drawback of “pre-insolvency” procedures is that it is problematic to adjust the capital structure of a solvent firm (for example, equity is not devoid of value so writing down to zero, as is common in Chapter

[12] One measure of cases in which liquidation might have been more efficient is refiling for a new bankruptcy process (sometimes referred to as “recidivism” or “Chapter 22”). Altman and Branch (2015) report that 15% of firms exiting Chapter 11 later refile. Iverson (2018) reports that recidivism is lower in courts that are not busy.

[13] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (OJ L 172, 26.6.2019, p.18).

11, may not be possible). The arrangement is also likely to create significant time pressure on restructuring procedures (if a firm becomes insolvent during the pre-insolvency procedure, it may need to switch to a liquidating procedure, reducing the likelihood of success). In theory, the value-maximising liquidation/continuation decision is not captured by the level of insolvency – an ideal system would base the liquidation decision solely on whether liquidation or continuation creates more value.

Making good decisions regarding liquidation or continuation requires courts to form a detailed opinion of the expected value in liquidation and continuation, involving external expertise. Concentrating larger bankruptcy cases in fewer courts is one avenue for developing expertise in and around the courts (see discussion below).

4.2 Cramdown for dissenting creditors

Stakeholders typically vote to approve an exit plan from insolvency. If all impaired classes vote in favour, in the United States (and many other jurisdictions) the debtor is allowed to exit the process. Since there can be many classes of creditors of different seniority, there is risk of dissent. This can slow down processes and create hold-ups (where a group refuses to approve a deal to receive a larger share of value, for instance). Junior creditors with limited economic interest may be able to hold up the approval of the exit plan. This provides a financial incentive to use voting power to extract value (unfairly).

The solution to the threat of hold-up in insolvency law is to grant courts the ability to overrule creditor classes that unreasonably refuse to approve a plan of reorganisation or otherwise impede the procedure. In Chapter 11, the judge can “cram down” a decision over dissenting votes under certain conditions. For example, the plan must pay secured creditors in cash and allocate to each class at least what they would have received in a liquidation (in which strict priority is followed). At least one class of impaired creditors needs to approve the plan, but the court can otherwise overrule as needed. European reforms have introduced cramdown possibilities recently, with some variation in exact details. For example, the German cramdown procedure requires a majority of creditor classes to approve, whereas Chapter 11 focuses on impaired classes only. The “concordato preventivo” in Italy gives creditors stronger veto rights. In this area, it appears that best practice in Europe and the United States is converging on how to give stakeholders an effective voice without allowing hold-ups, but differences remain in who can object and how.

4.3 Protecting the going-concern value of insolvent firms

For firms that are restructured rather than liquidated, one aim for the insolvency process should be to improve the firm’s value by protecting or increasing its going-concern value. This may require intervention in the firm’s contracts with third parties. Three main areas are particularly important: automatic stays, ipso facto clause enforcement and contract rejection.

First, some form of stay (or moratorium) on debt enforcement is usually necessary to prevent secured creditors withdrawing collateral from insolvent firms (see, for example, Vig, 2013).

Second, blocking the enforcement of ipso facto clauses is key to restructuring. Ipso facto clauses typically grant one party to a contract the power to impose additional costs or a right to exit a contractual relationship in the event of counterpart insolvency. They can be part of agreements like supplier contracts or leases. Generally, enforcing ipso facto clauses makes restructuring difficult, because business operations are severely impeded when contracts are suddenly terminated. Enforcement of these clauses against firms in insolvency proceedings varies across EU countries, despite some harmonisation brought about by the EU Insolvency Directive. Finland, Germany and Italy, for example, do not enforce such clauses (i.e. there is an automatic stay on the enforcement of ipso facto clauses against firms that are in a proceeding), whereas Austria and the Netherlands do (see Chuah and Vaccari, 2023). This presents a possible target for legal harmonisation.

Third, the management of non-financial obligations – particularly those created by long-term arrangements such as leases, supply contracts and licences – is critical for an effective corporate restructuring system. Just as a firm can be insolvent due to the burdens from financial debt, it can also be insolvent due to the burden imposed by contractual obligations. The US approach is to give firms in Chapter 11 protection full and largely unconstrained rights to reject leases and other contracts and thereby maximise the possibility of successful restructuring.[14] Such liberal rules for the rejection of executory contracts enhances the credit capacity, especially in industries where rental agreements are common, such as retail, restaurants and hotels (see Becker et al., 2024). The rules according to which contracts can be rejected vary across the EU and are generally restrictive (e.g. subject to counterpart approval). This area presents another possible target for reform.

4.4 Multi-entity procedures

Many firms consist of multiple legal entities. For example, large firms often have structures where a “HoldCo” owns all the shares in separate “OpCo” (operations) and “PropCo” (assets) entities. Firms also tend to have legal entities in each country where they operate and sometimes, for regulatory reasons, across industries. A group-wide insolvency process must be able to handle multiple entities.

Multi-entity procedures are necessary to achieve equitable and predictable outcomes across different parts of a business group (i.e. equal treatment of creditors of equal rank). They are also essential to avoid a run-like dynamic where creditors competitively push for speedy resolution of the entity that is their counterpart and to protect the going-concern value (which typically requires keeping the various pieces together). Since most European insolvency processes do not allow joint filing, large firms have an incentive to use the US system whenever possible.[15] In order to allow large firms to be handled, it is necessary to introduce the option of multi-entity procedures in some meaningful way, and this presents a further possible target for Europe-wide reform.

[14] Several other countries follow a similar approach, at least in theory, including Bangladesh, Greece and Israel (see Chuah and Vaccari, 2023).

[15] A recent example is Scandinavian Airlines, whose US Chapter 11 procedure covered 11 corporate entities, including Irish subsidiaries used for airplane leases, a holding company which had issued bonds and several regional operating entities (Southern District of New York, Case No. 22-10925 “SAS AB”).

4.5 Specialised courts

A more sophisticated insolvency framework − and especially one that restructures (rather than liquidates) and that handles large firms − necessarily asks more of courts, lawyers and other professionals involved. Courts need to take a larger number of more complex decisions, and court expertise is developed in large part through experience. Therefore, more sophisticated insolvency law may require concentrating cases in fewer courts. As a benchmark, US bankruptcy comes under federal law, and most large cases are handled in only three courts (Delaware, Southern District of New York and more recently Texas).

4.6 Small firms

Small firms do not require the full machinery of a Chapter 11-style insolvency procedure. Indeed, they may be better served by a faster and cheaper system that is specifically targeted at resolving smaller firms. Hotchkiss et al. (2024) describe 2020 reforms to simplify the process for firms with assets of less than USD 7.5 million in Subchapter V of Chapter 11. These reforms include maintaining equity interests even if creditors experience losses (to preserve owner-operator incentives), appointing a trustee to work with management and sometimes foregoing an unsecured creditor committee. For European economies where smaller firms play a more substantial role than in the United States, these considerations are even more important. To effectively handle both small and large firms likely requires separate insolvency frameworks (or separate tracks within the same system).[16]

4.7 Harmonisation and predictability

The significant heterogeneity across EU national insolvency frameworks has resulted in repeated calls for harmonisation (see, for example, Letta, 2024). The argument is that harmonisation would increase predictability in insolvency outcomes. For firms that operate across multiple jurisdictions, harmonisation would reduce uncertainty regarding which law would be applied if the firm filed for bankruptcy. This may be especially true for corporates that are large and valuable enough to consider non-European regimes such as Chapter 11 of the US Bankruptcy Code, where the differences in process are significant.

Harmonisation would facilitate cross-border investment that may not materialise currently due to unfamiliarity with insolvency frameworks in other countries. Both consistency and greater predictability should reduce risk premia and hence facilitate deeper integration of financial markets across the EU.

At the same time, full harmonisation of national insolvency frameworks across the EU would be very difficult to achieve. Moreover, it is not necessarily desirable to fully harmonise national

[16] In line with this observation, the 2022 proposal for a directive on harmonising certain aspects of insolvency law (see above) foresees simplified insolvency procedures for micro- and small firms.

systems, given that these systems may work well for certain types of firms and in the context of wider national legal systems.

5 A proposal: an EU-wide opt-in insolvency framework

We conclude with a policy proposal. The proposal is based on two premises, building on the preceding discussion. First, the EU has much to gain from more effective and better harmonised insolvency frameworks. This would be a significant step in driving forward the capital markets union which, in turn, constitutes an important building block in facilitating investment in infrastructure, defence and the green transition. Second, fully harmonising all 27 national insolvency frameworks across the EU is almost certainly not politically feasible. It is also potentially undesirable, given that national frameworks may serve some firms well.

These objectives can be achieved by creating a new EU-wide insolvency framework that is available on an opt-in basis. This EU-wide framework would exist alongside the 27 existing national frameworks – it would therefore constitute a "28th regime".

Because the EU-wide opt-in insolvency framework would be created from scratch, it could be structured to specifically include the desirable features of efficient insolvency frameworks discussed in Chapter 4, including the ability to handle large and complex restructurings in a predictable fashion. By design, the EU-wide opt-in framework would be uniform across the whole EU. Firms that opt into the framework could therefore reap the benefits from an efficient and harmonised EU-wide framework, which would provide an important boost to the capital markets union.[17]

The EU-wide opt-in framework would exist alongside current national frameworks. This means that there would be no need for significant insolvency reform or harmonisation at the national level. This is a major benefit, because it has proven politically difficult to harmonise insolvency frameworks across national jurisdictions.[18] In fact, this is one reason why most recent EU insolvency reforms have focused on "pre-insolvency" measures such as "preventive restructuring" which can be implemented without major reforms of national insolvency laws. Pre-insolvency measures are limited in what they can achieve and, most importantly, by themselves cannot generate the benefits of efficient insolvency frameworks described in Chapter 4 (see, for example, Becker, 2019). While the EU-wide opt-in framework would be mainly targeted at large firms, larger SMEs could also benefit, particularly if the EU-wide opt-in framework improves their access to European capital markets.

Another advantage of the EU-wide opt-in framework is that no one is forced to use it. Firms can continue to rely on their national frameworks if they choose to do so. Firms that are served well by national frameworks can therefore continue to use them, while those that would benefit the most from the uniform EU-wide framework could opt in. Indeed, offering firms a choice of frameworks is not a new idea. It has been advocated by legal scholars (see, for example, Rasmussen, 1992, 1997, and Eidenmüller, 2017), partly to address the specific challenges posed by multinational

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17 While the ability to opt into the EU-wide insolvency system at the time of filing would already generate significant benefits, the predictability of outcomes could potentially be further improved if firms can commit ex ante to use the EU-wide system.

18 In addition to the political challenges of harmonising national insolvency frameworks, there are also legal difficulties, as pointed out by the European Central Bank (2017).

bankruptcies. Concentrating cases in a few courts could enhance their development of the required legal, financial, and turnaround expertise.

In short, an EU-wide opt-in insolvency framework would provide a blank slate to draw up an efficient, uniform insolvency framework without the need for major reforms at the national level. It would make the advantages of an effective, uniform insolvency framework available to those firms that benefit from it. At the same time, firms served well by national insolvency frameworks would continue to have access to these.

Despite the advantages discussed above, the introduction of a 28th regime clearly would not be without challenges. First, a fundamental question is which courts would act as the legal venue. Given that the effectiveness of a 28th regime would depend significantly on the availability of competent courts, the creation of specialised courts may be justified. It would, however, require significant resources to set up such courts. Second, even though a 28th regime would, by definition, be uniform across the EU, it would interact with other areas of national law that are not harmonised. For example, it would be necessary to consider how the EU-wide opt-in framework would interact with national corporate and tax law. Third, the definition of insolvency across countries might need to be harmonised, and agreement may need to be reached on generic priority rules. Given the significant potential benefits of a 28th regime, however, these challenges do not seem insurmountable.

6 Conclusions

The process for handling insolvency and distress is key to corporate credit markets, the financial system and economic renewal. As European systems improve, economic vitality increases. Yet, several serious shortcomings remain in European insolvency frameworks, including the ability to resolve insolvency and distress in a transparent, predictable way for large firms with complex balance sheets, intangible assets and multinational operations, without liquidating in a value-destroying manner. Recessions, financial crises and periods of stress, such as the COVID-19 pandemic, highlight the need for orderly, value-maximising resolution systems.

We discuss areas where European insolvency law could be reformed, including the introduction of an EU-wide opt-in insolvency framework targeted at larger and economically significant firms that may currently avoid using insolvency frameworks to restructure (at the cost of reduced risk appetite and slower growth), rely on informal restructuring mechanisms (with lower transparency and fairness) or go abroad (at high cost). Because this framework would be designed from scratch, it offers an opportunity of achieving the benefits of a well-functioning insolvency framework without the need to reform each national insolvency framework. Moreover, because the new insolvency framework would apply throughout the EU, it would offer EU-wide predictability and uniformity − key factors for reaping the benefits from a well-functioning capital markets union (see Letta, 2024). Finally, the opt-in feature of our proposal means that firms which are served well by insolvency law in their national jurisdiction (for example, because they do not require access to EU-wide capital markets) continue to have access to their national insolvency frameworks.

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Appendix A: Current insolvency trends

This appendix contains a summary of current trends in the number of insolvencies, with a focus on EU countries and, for reference, the United States.

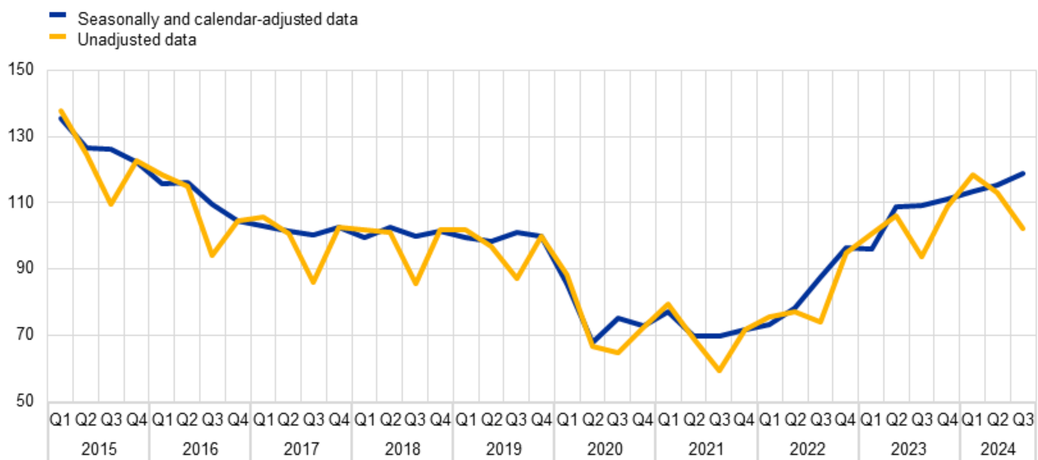
Chart A1 plots EU business bankruptcies from 2015 to 2023. The chart shows that, rather than the feared increase, EU bankruptcies decreased after the onset of the pandemic. This fall can be attributed to support measures introduced across EU economies. More recently, however, business bankruptcies in the EU have started to increase. While some of these bankruptcies were likely simply postponed by pandemic-era support measures that have now been phased out, others reflect changes in the economic environment, including increased borrowing costs and higher energy prices.

While these increases are sizeable in terms of year-on-year percentage changes, Chart A1 shows that bankruptcies are now slightly above their 2019 pre-pandemic levels. Chart A2 illustrates a similar pattern for the United States, where Chapter 11 filings in 2023 lie slightly above the 2019 pre-pandemic level.

Chart A1

Declarations of bankruptcy in the EU

(index: Q4 2019 = 100)



Source: Eurostat.

Chart A2

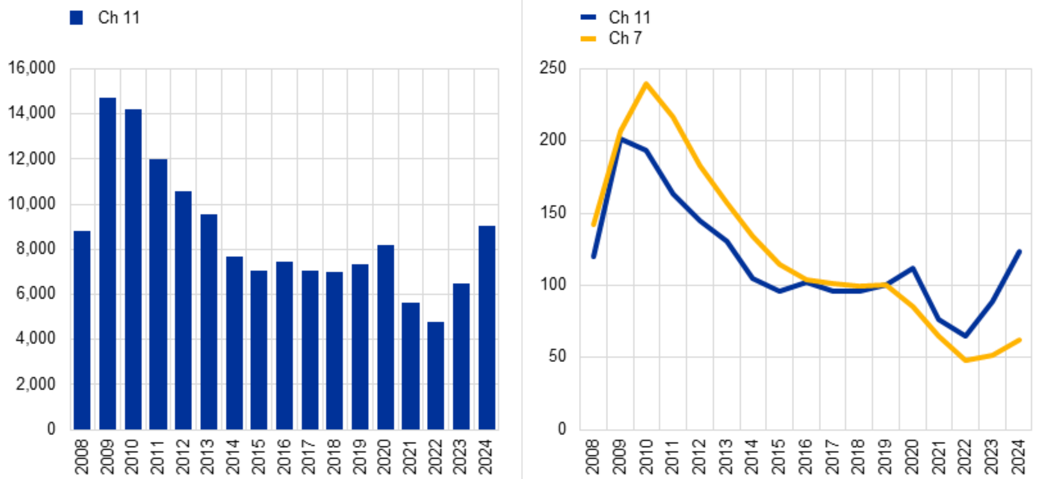
Bankruptcy filings in the United States

a) Number of filings to Chapter 11

(number of filings)

b) Filings to Chapter 7 and to Chapter 11

(index: 2019 = 100)



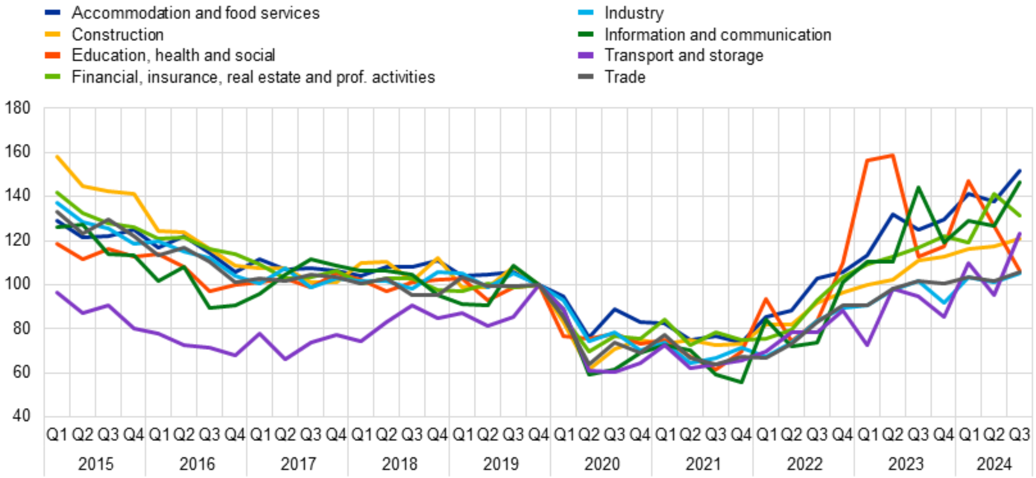
Sources: ABI, US courts.

There is significant heterogeneity in European business bankruptcies across countries and industries. Chart 1 plots European business bankruptcies relative to their 2021 levels. While total EU business bankruptcies slightly above their pre-Covid levels, the increase is driven by a few countries. In some of these countries, this increase may be partly driven by reforms implemented during the pandemic that made it easier for firms to restructure in bankruptcy. Chart A3 shows EU bankruptcies across sectors. While there has been a modest general upward trend in bankruptcies since 2020, some of the biggest post-pandemic increases occurred in accommodation and food services as well as transport and storage.

Chart A3

Bankruptcies in the EU, by sector

(index: Q4 2019 = 100)

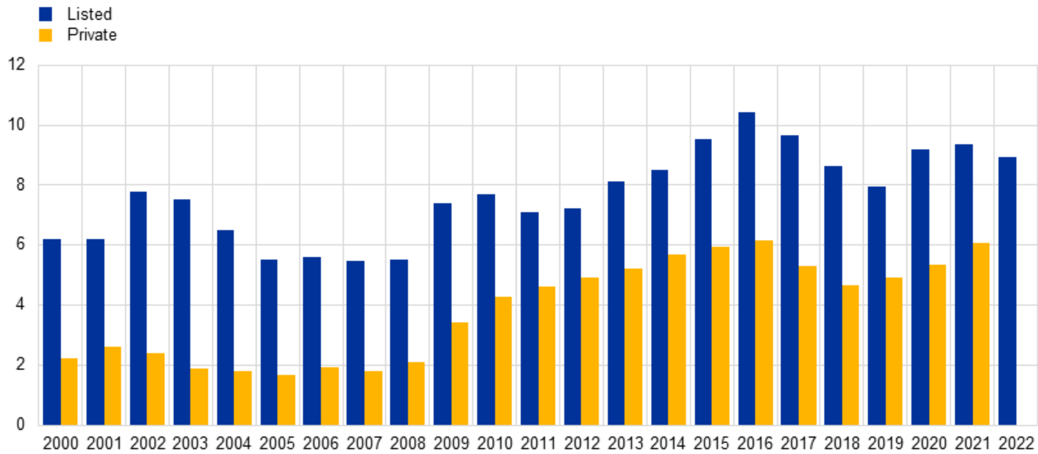


Source: Eurostat.

Alongside the modest increase in the number of bankruptcies, according to some measures there has also been an increase in so-called zombie firms globally, including in the EU (see Albuquerque and Iyer, 2023). Zombie firms are unproductive and economically unviable firms that nevertheless continue to operate. Empirically, Albuquerque and Iyer (2023) categorise a firm as a zombie if three conditions are met for two consecutive years. The firm in question must have (i) an interest coverage ratio below one, (ii) above-median leverage relative to firms in the same industry, and (iii) negative real sales growth. Chart A4 reproduces the main finding from this paper. Following on from a downward trend from 2016 to 2019, the share of firms with zombie status has been increasing globally since 2020.

Chart A4
Share of firms with zombie status

(percentages)

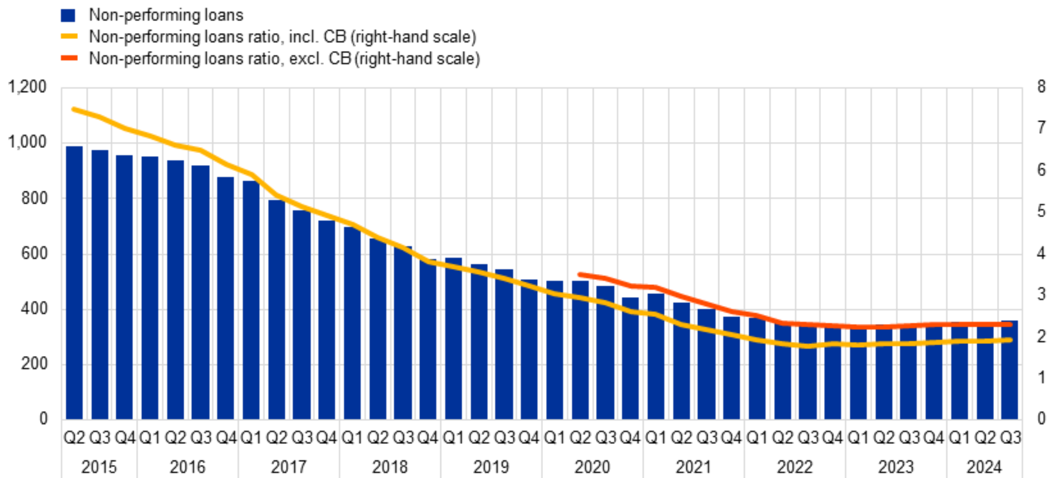


Source: Albuquerque and Iyer (2023).

Despite the recent uptick in bankruptcies in the EU, aggregate statistics do not yet show an increase in non-performing loans. Chart A5 shows that non-performing loans have remained stable since about 2020 at an average ratio of 2.3% across countries participating in European banking supervision.

Chart A5
Non-performing loans of significant institutions under European banking supervision

(left-hand scale: EUR billions, right-hand scale: percentages)



Source: ECB.
Note: CB refers to cash balances at central banks and other demand deposits.

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