McKinsey&Company

InsO Survey 2018

McKinsey&Company Noerr

Survey results | Jan 2018

Executive summary

- The topic of the McKinsey/Noerr InsO Survey is **satisfaction with German insolvency law**. The 350 experts surveyed show where there is still **room for improvement in German insolvency law** and provide lawmakers with ideas as to how restructuring can be made more attractive in Germany.
- On the whole, the experts surveyed gave **German insolvency law good marks**, but no “very good”.
- The experts suggested that **lawmakers prioritize** primarily the following issues:
  - **Professionalizing insolvency courts:** 89% of the experts advocated eliminating at least one-half of the insolvency courts.
  - **Introducing a pre-insolvency procedure:** Germany could make a good impression by implementing it before an EU directive is issued.
  - **Increasing liability in the context of self-administration**: self-administration should entail the same liability as an insolvency administrator has.
- Action is also needed on insolvency claw-back, rules on preliminary creditors’ committees, certificates pursuant to Sec. 270b InsO and debt-equity swap.
- With the improvements cited in the survey, **Germany can gear up for the** post-Brexit **competition to be the new "restructuring hub".**

Contents

The ESUG is generally positively received: mark: GOOD but not VERY GOOD

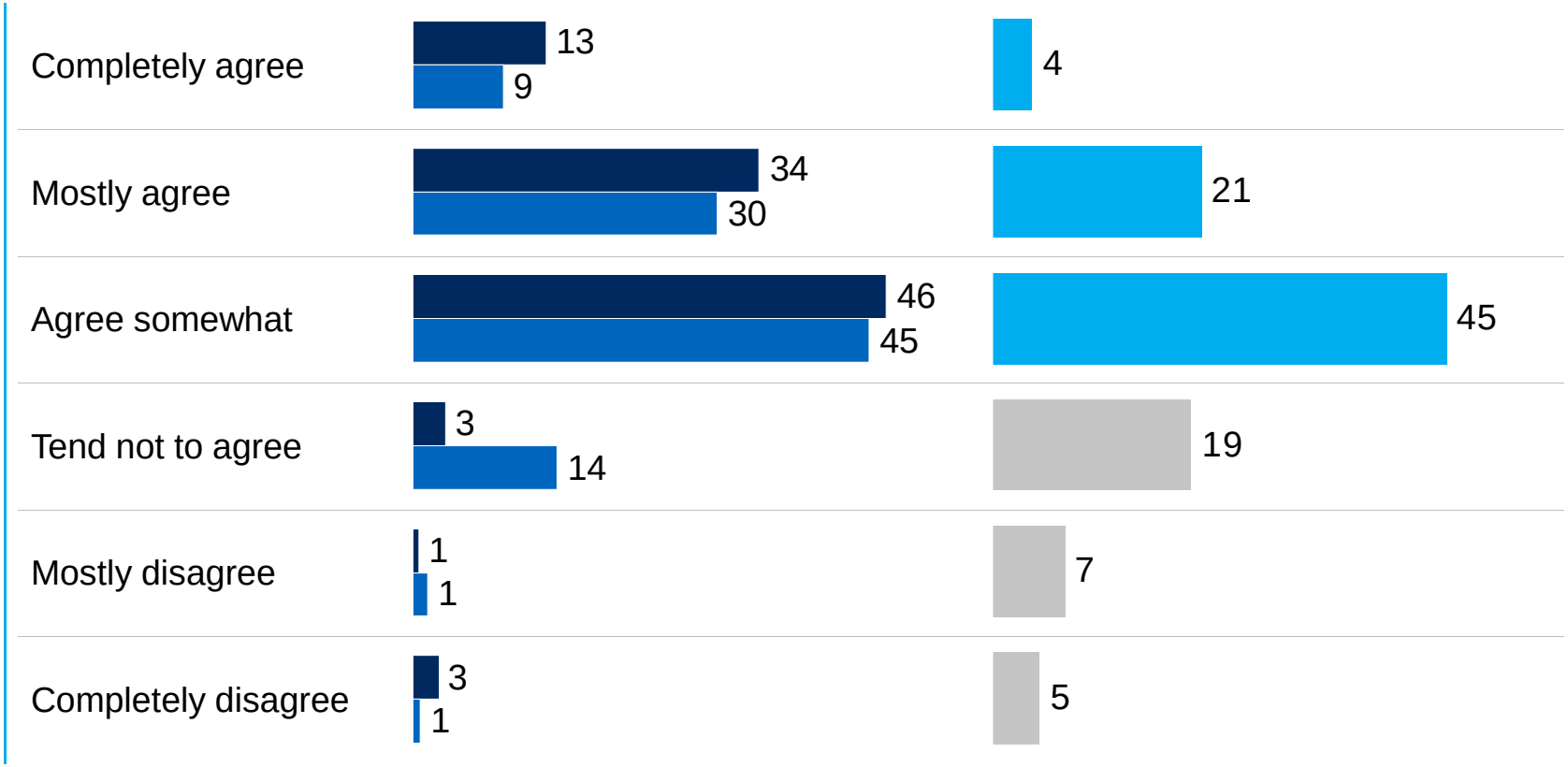
Figures below are percentages

The changes in the ESUG have made German insolvency law more attractive compared …

… to the legal situation before the ESUG

… to other legal systems

The amendments to Germany's Insolvency Code have already caused a change in mentality. Insolvency is now understood as an opportunity.



SOURCE: Noerr; McKinsey

The InsO survey is based on approximately 350 completed questionnaires and was conducted from September to November 2017

The figures cited below represent percentages.

Survey Sept.-Nov. 2017[1]

1 348 questionnaires were filled out 2 e.g. members of corporate governing bodies, representatives of companies to be restructured, others

SOURCE: Noerr; McKinsey

Top 3 topics: professionalizing insolvency courts, pre-insolvency procedure and liability in self-administration

The figures cited below represent percentages.

Agreement[1]	Which three proposals do you consider the most important?	
89	Professionalizing insolvency courts	23
70	Introducing a pre-insolvency procedure	19
87	Increasing self-administration liability	17
62	Limiting claw-back	11
88	Limiting self-administration	11
92	Increasing liability for issuers of false Sec. 270b certificates	8
57	Regulating the appointment of preliminary creditors' committees	4
82	Introducing an assessment framework for claims in debt/equity swaps	4

1 "necessary" or "expedient"

SOURCE: Noerr; McKinsey

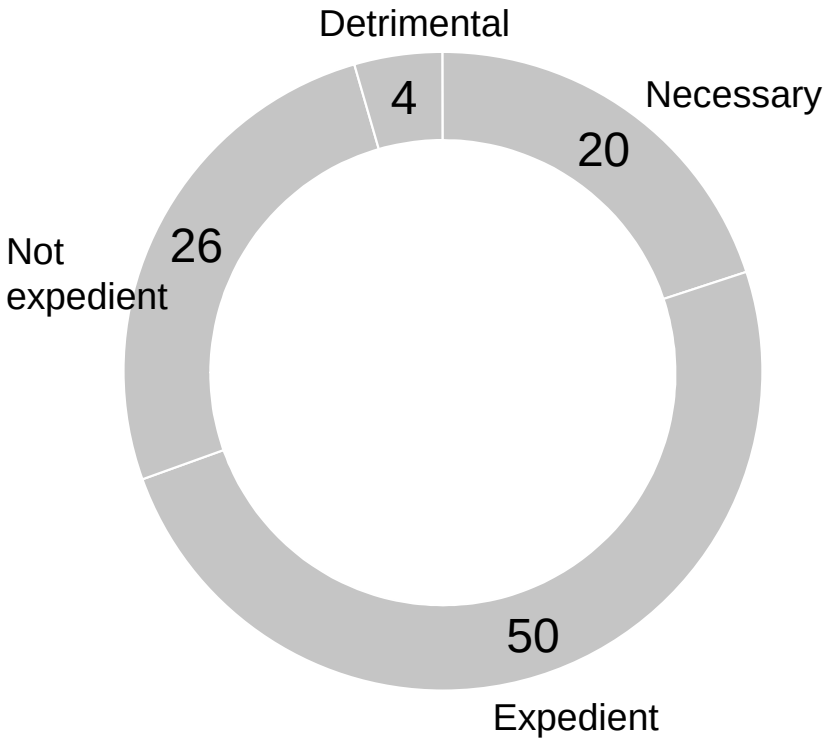
Contents

Germany needs a pre-insolvency restructuring procedure that should be introduced before an EU directive is issued

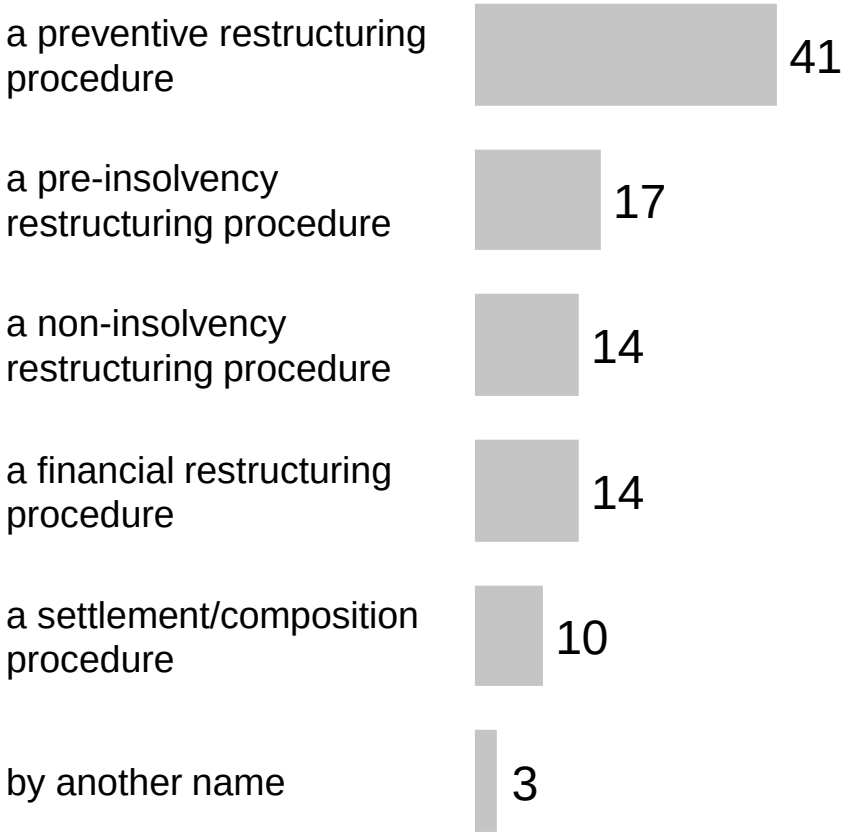
The figures cited below represent percentages.

Germany needs a pre-insolvency restructuring procedure …

… in which an accepted restructuring plan can be limited to a group of creditors.



It should be called …



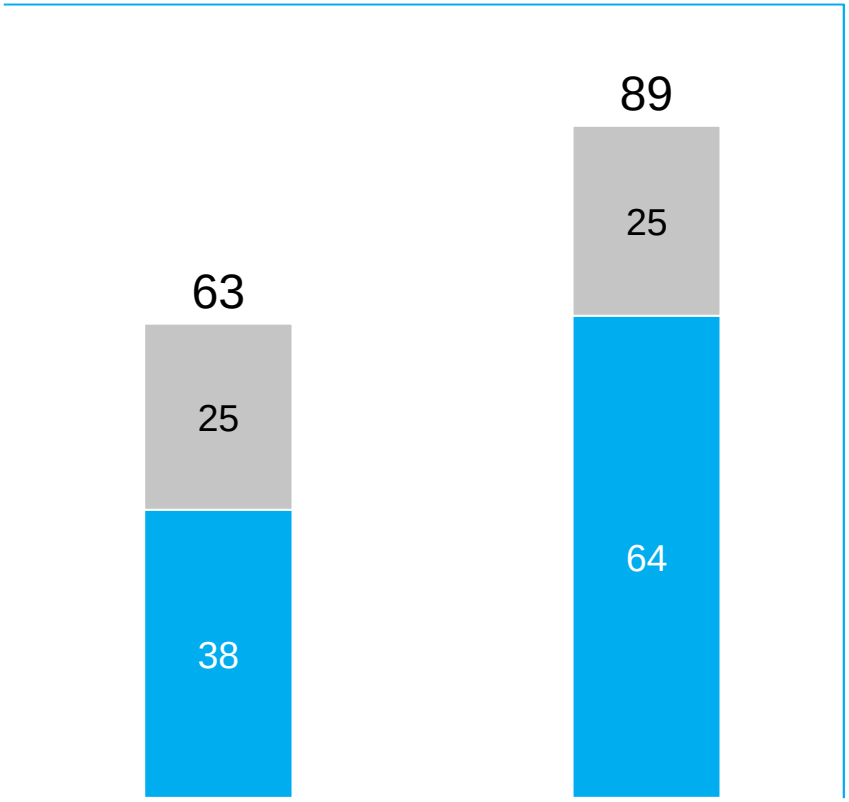
SOURCE: Noerr; McKinsey

The pre-insolvency restructuring procedure must be supervised by an independent practitioner whom the court appoints and who takes action

The figures cited below represent percentages.

The pre-insolvency restructuring procedure …

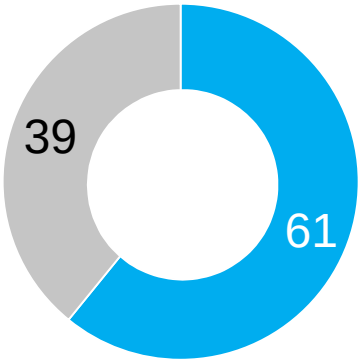
… should be a court proceeding (in contrast to e.g. in Sec. 5 SchVG)[1]



… must be supervised by an independent practitioner

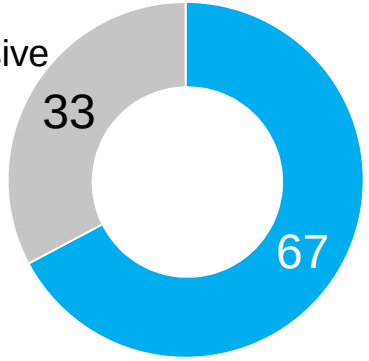
The neutral supervisor should …

be chosen by the debtor and confirmed by the court.



be appointed by **the court.**

assume a passive supervisory/ moderating role.



take an active role (e.g. provide mandatory consent, approve the restructuring plan)

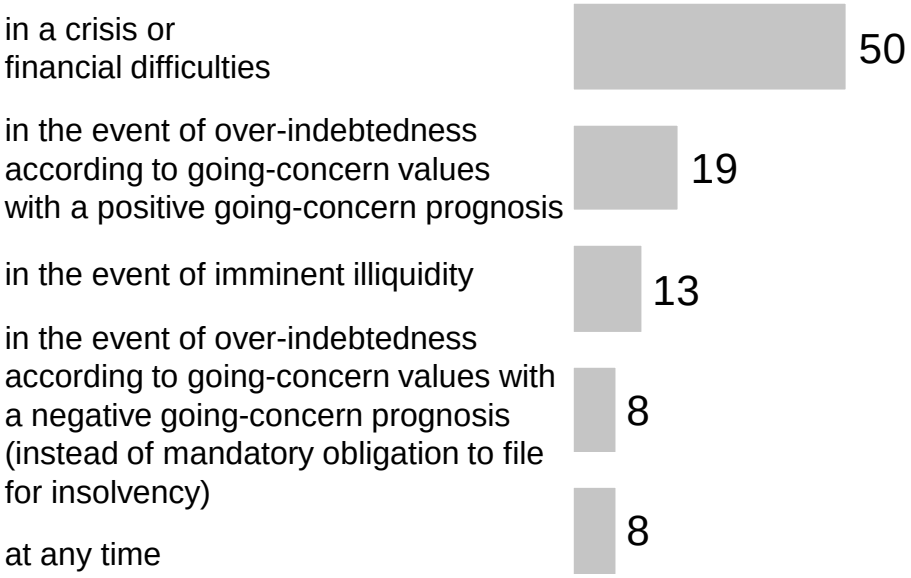
1 German Act on Notes, *Gesetz über Schuldverschreibungen aus Gesamtemissionen*

SOURCE: Noerr; McKinsey

A pre-insolvency restructuring procedure should be an option in a crisis or a case of over-indebtedness

The figures cited below represent percentages.

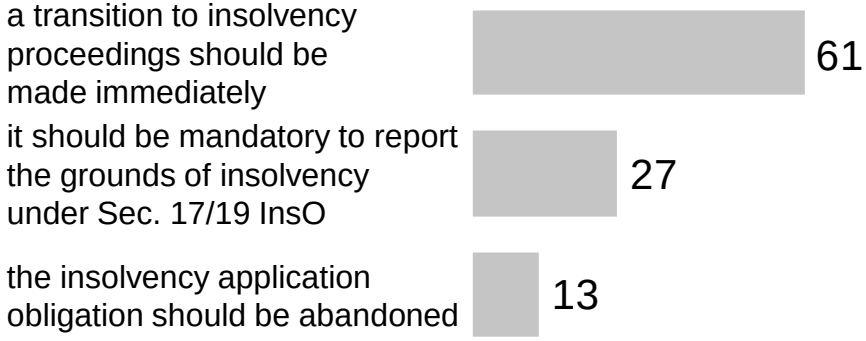
A pre-insolvency restructuring procedure should be an option[1] ...



Art. 4 of the draft EU directive[2]: an option in financial difficulties and imminent bankruptcy

In accord with the draft directive[2]

If grounds for an application for insolvency arise in the course of a pre-insolvency restructuring procedure,...



Art. 6/7 of the draft directive[2]: the obligation to apply for insolvency can be inapplicable. Exception: debtor is not in a position to cover the debts accruing during the suspension.

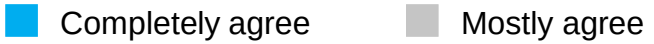
In contradiction to the draft directive [2]

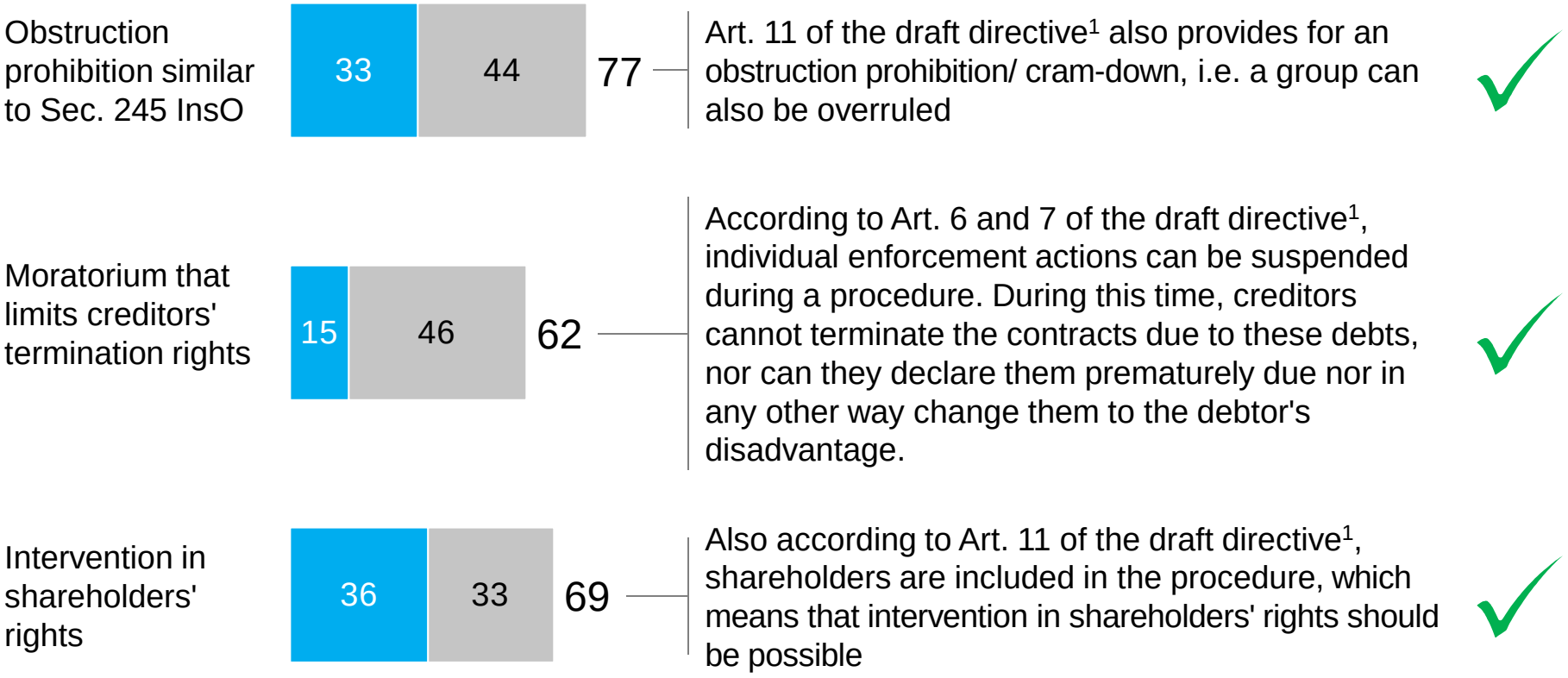
1 not including those who answered "other" (2)
2 draft directive on a preventive restructuring framework

SOURCE: Noerr; McKinsey

A pre-insolvency restructuring procedure should prohibit obstruction, include a moratorium and permit intervention into shareholders' rights

The figures cited below represent percentages.





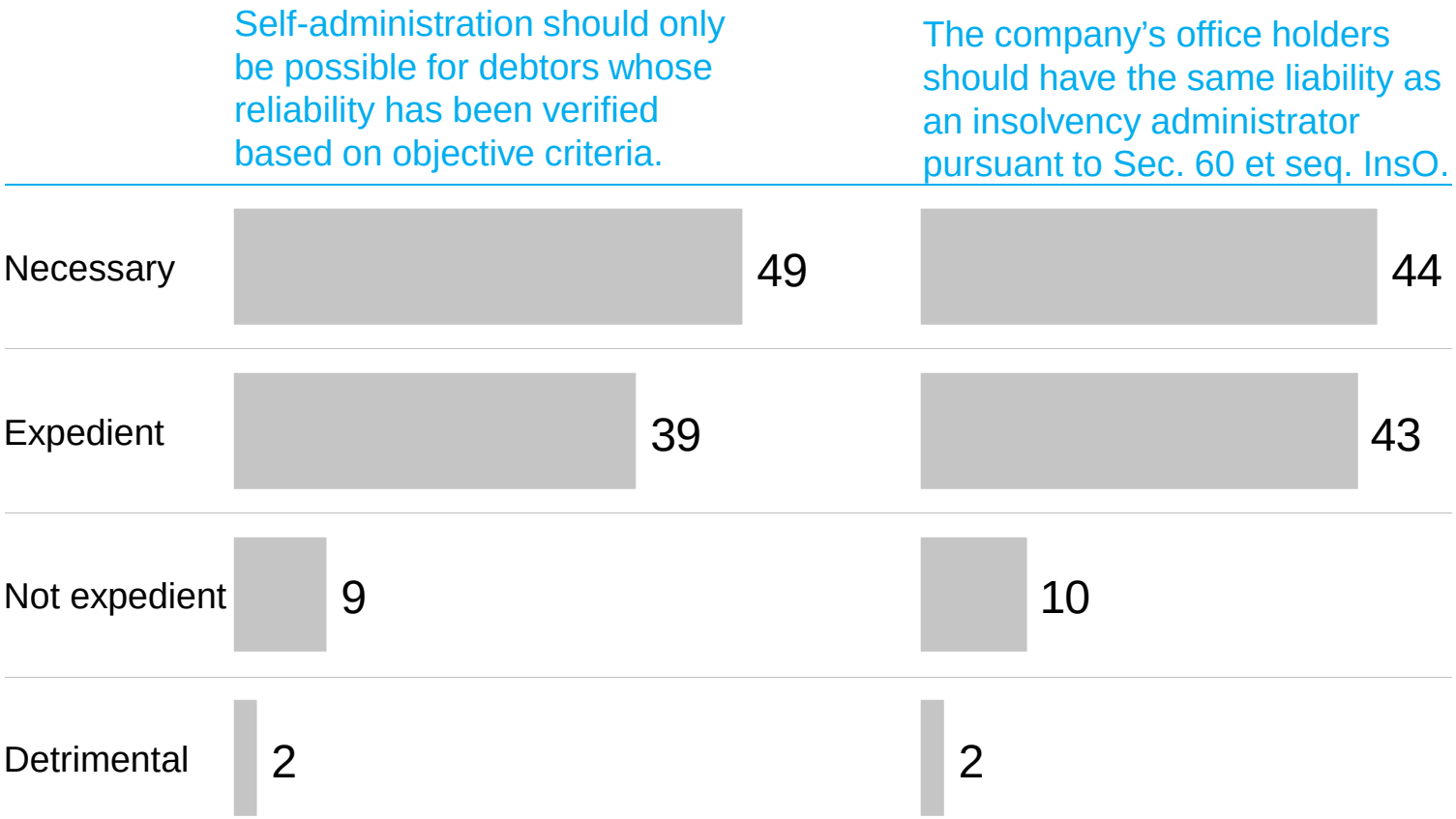
All three in accord with the draft directive[1]

1 draft directive on a preventive restructuring framework

SOURCE: Noerr; McKinsey

Self-administration should only be possible for reliable debtors, and self-administering office-holders' liability should be the same as insolvency administrators'

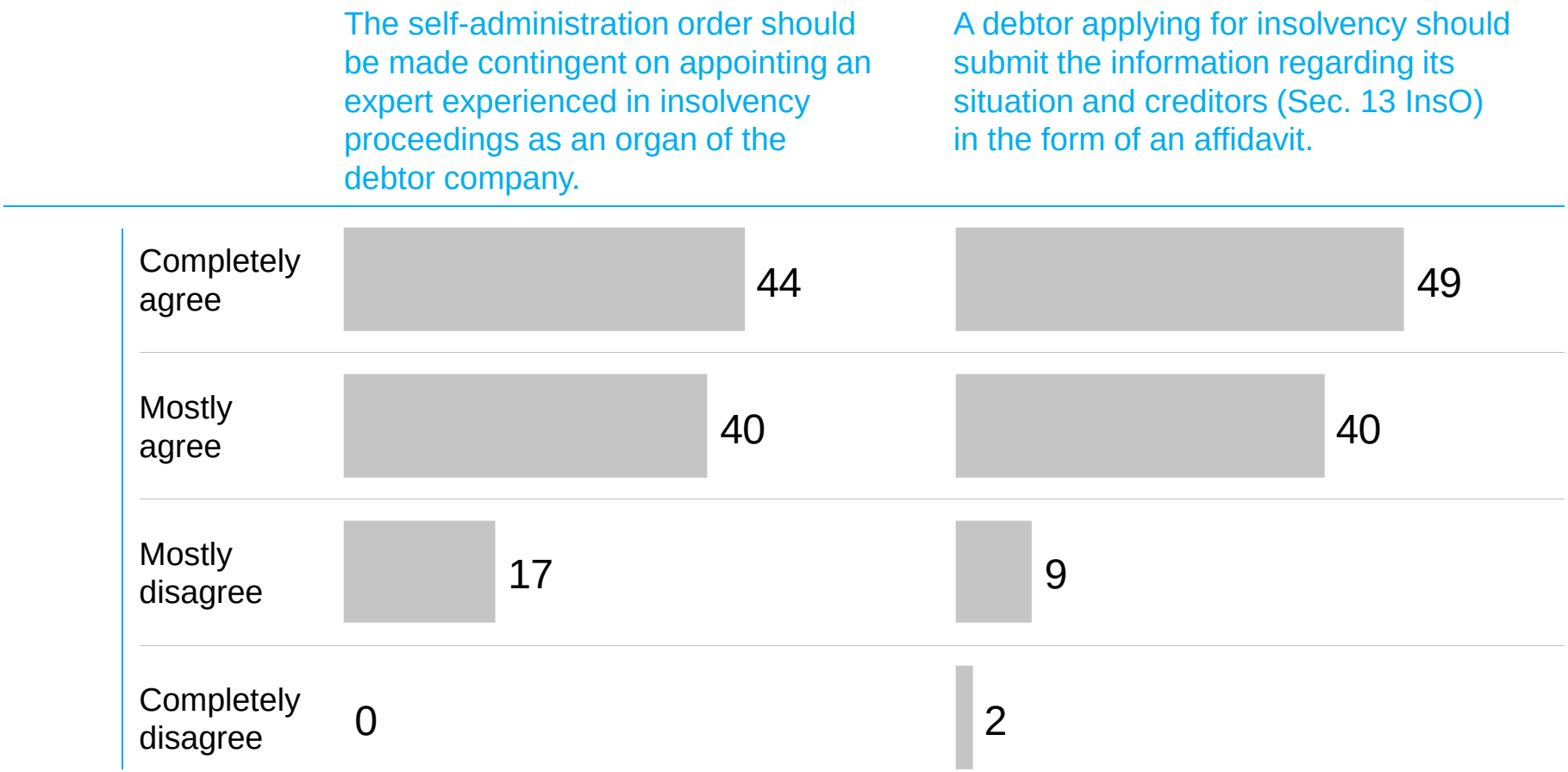
The figures cited below represent percentages.



SOURCE: Noerr; McKinsey

Self-administration should only be ordered with an insolvency expert and information on situation and creditors

The figures cited below represent percentages.



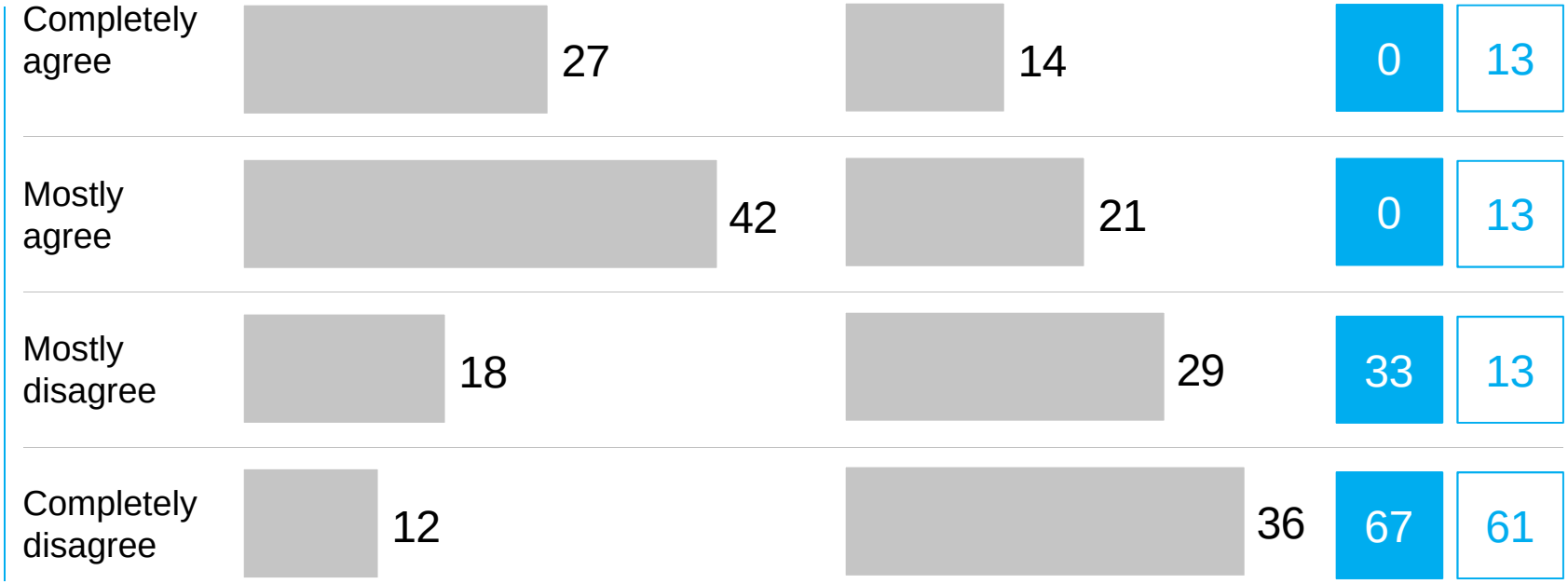
SOURCE: Noerr; McKinsey

Broad consensus on a custodian's advisory function – however, reduction in remuneration not necessary according to experts

The figures cited below represent percentages.

According to the German Federal Court of Justice, a custodian only advises self-administration and does not steer the restructuring process himself/herself.[1] With this role of the custodian, I

The custodian's remuneration must be reduced.



A custodian only advises on the self-administration – but at 60% of the remuneration of an insolvency administrator is to continue to receive more remuneration than advisors or the self-administration, for which 40% of the administrator's remuneration is usually set.

1 No authority to draft plans but must assess and verify the plausibility of the self-administration's plans, which means more than subsequent approval.

SOURCE: Noerr; McKinsey

Liabilities against assets are widely created in actual practice of self-administration and should be quickly implemented by lawmakers

Lawmakers should clarify that the debtor can be authorized by the insolvency court in preliminary self-administration procedures pursuant to Sec. 270a InsO to create liabilities against assets

Commentary:

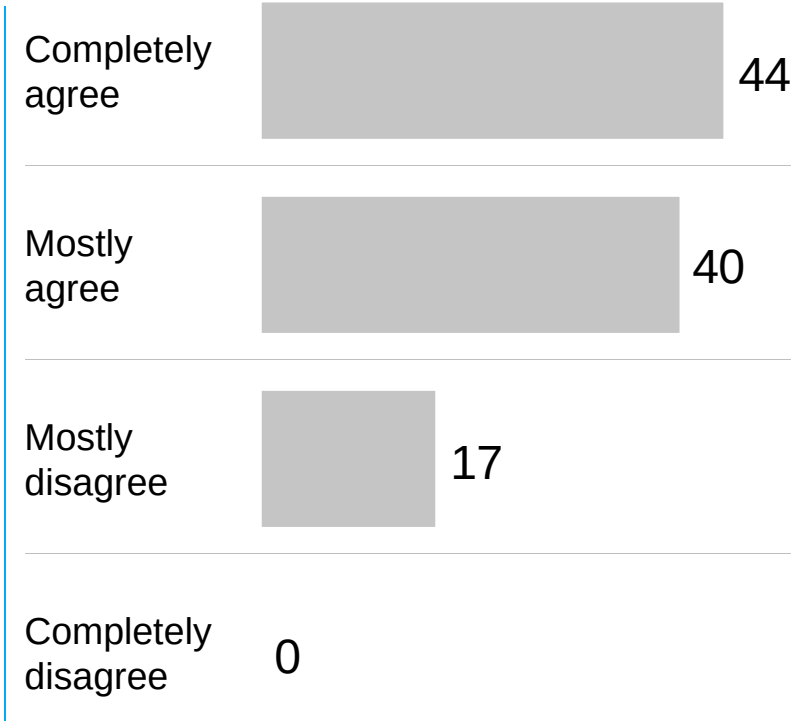
- It has not yet been clarified whether the debtor in a preliminary self-administration pursuant to Sec. 270 a InsO can be authorized by the court to create liabilities against the assets – a decision by the Federal Court of Justice is pending.
- Insolvency courts have had differing reactions to such applications by debtors, but have more often than not issued the corresponding individual authorization.

SOURCE: Noerr; McKinsey

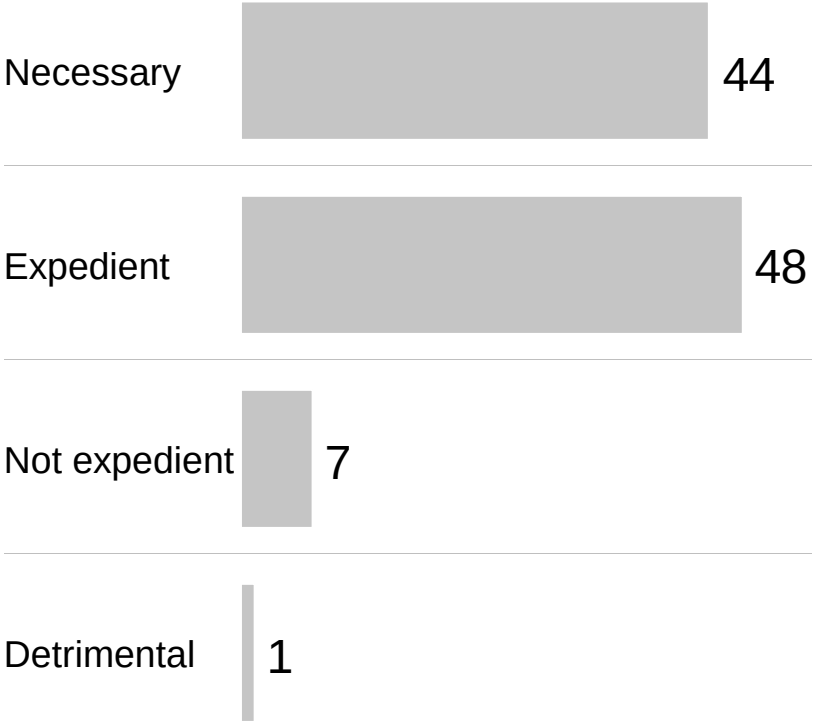
The issuer of a Sec. 270b certificate should not have been engaged by the company before the restructuring and should have increased liability

The figures cited below represent percentages.

The issuer of the certificate pursuant to Sec. 270b InsO should not have been engaged by the company in an auditing or consulting role previous to the restructuring.



There must be civil liability for issuing false Sec. 270b certificates.

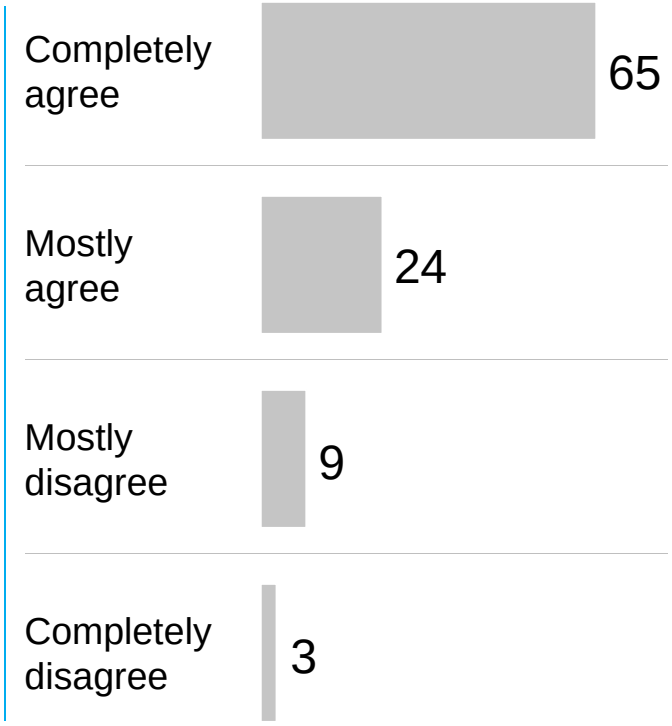


SOURCE: Noerr; McKinsey

The Sec. 270b certificate should have a legally mandated minimum content

The figures cited below represent percentages.

The certificate should have a legally mandated minimum content because it is an essential prerequisite for successful restructuring.



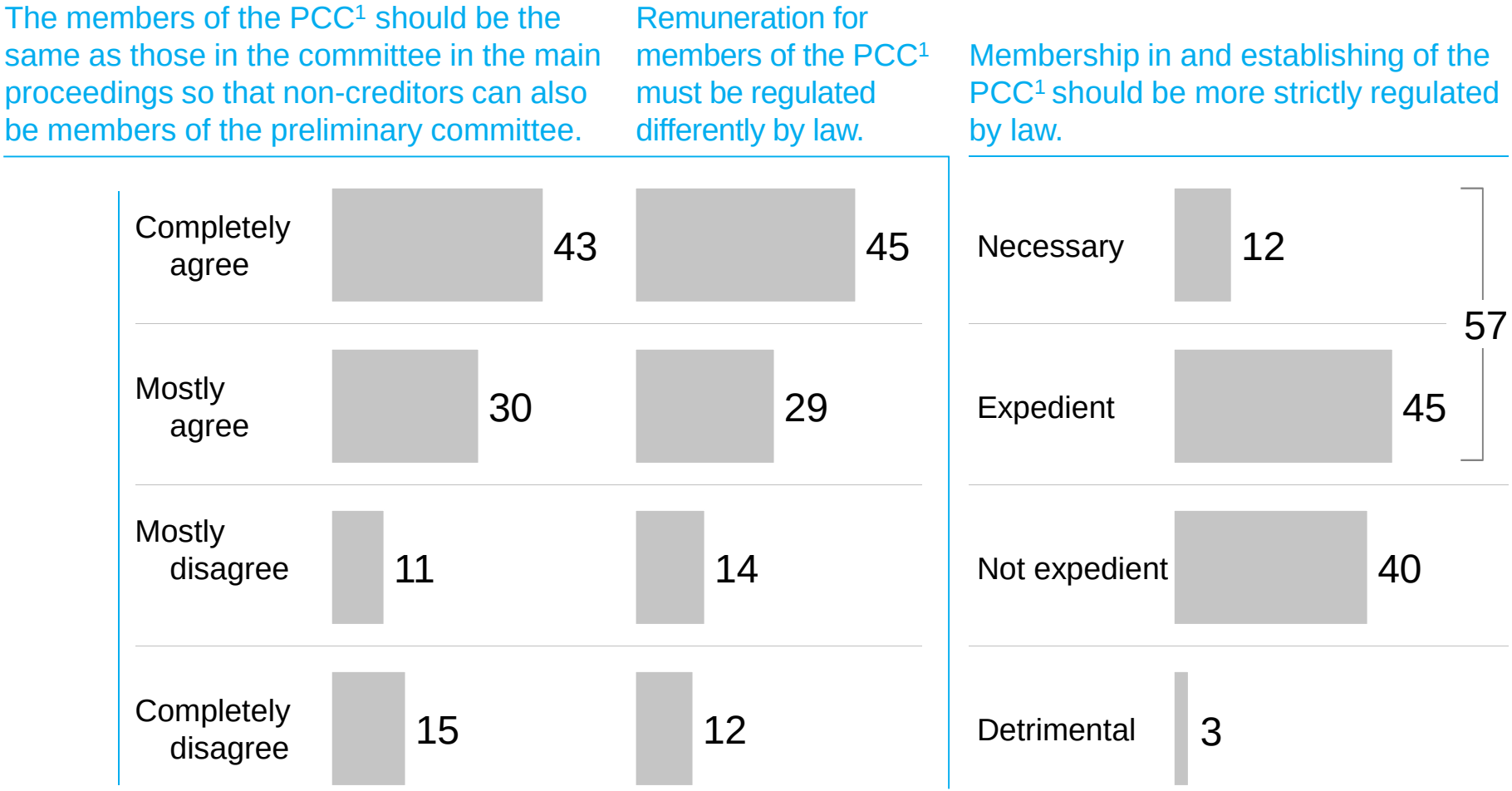
Commentary:

- The restructuring suggested in the insolvency procedure is not permitted to be obviously without any prospect of success (Sec. 270b (1) Sentence 1 InsO). This constitutes a significantly lower hurdle than that set by the law for a positive going-concern prognosis pursuant to Sec.19 InsO and the ability of an enterprise to be restructured. Accordingly, the continued business and/or restructuring must be predominantly probable; in other words, the probability must be more than 50%.
- The content of restructuring expert opinions already conforms to differentiated case law of the Federal Court of Justice. This could be used for Sec. 270b certificates.

SOURCE: Noerr; McKinsey

The preliminary creditors' committee should not be just for creditors – action needed on remuneration and appointment

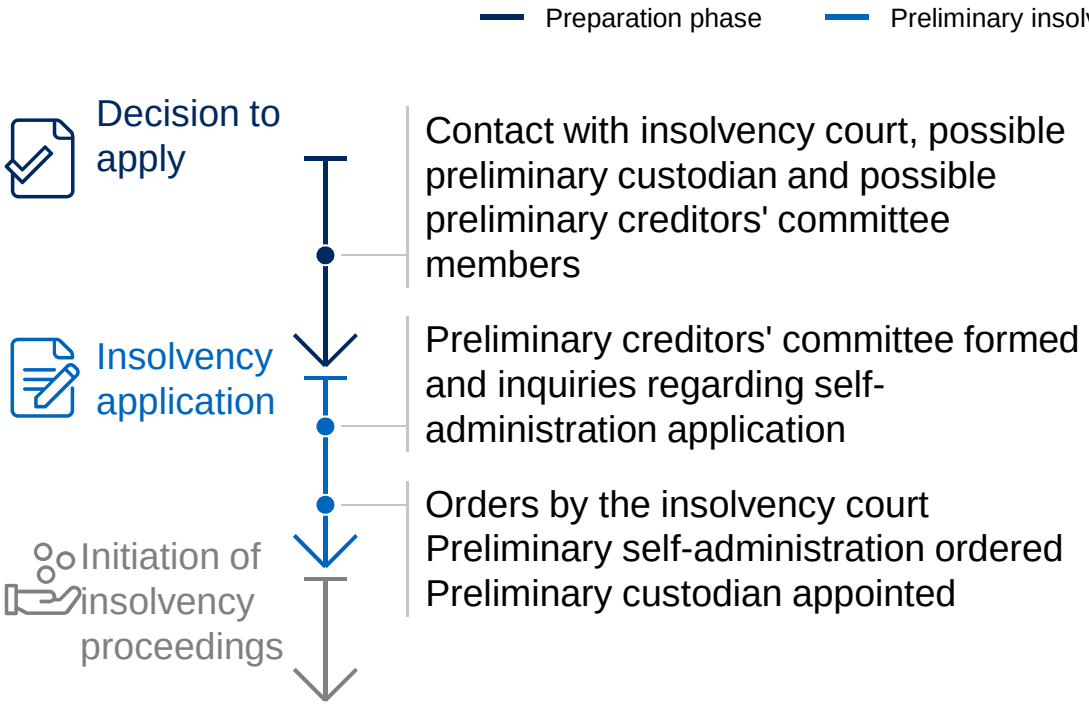
The figures cited below represent percentages.



1 Preliminary creditors' committee

SOURCE: Noerr; McKinsey

Before self-administration is ordered, creation of a preliminary creditors' committee should be mandatory and not at the court's discretion

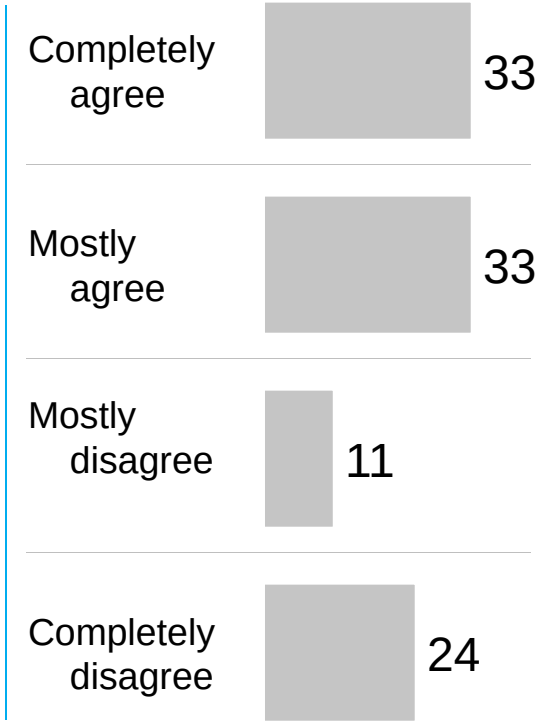


Commentary:

When a PCC[1] is created before the preliminary self-administration is ordered and the custodian appointed, it can participate in the decision-making process and its opinion can be taken into account. This strengthens the creditors' influence.

Upon application for self-administration, it should be mandatory to appoint a PCC[1] before the court reaches a decision.

The figures cited below represent percentages.



1 Preliminary creditors' committee

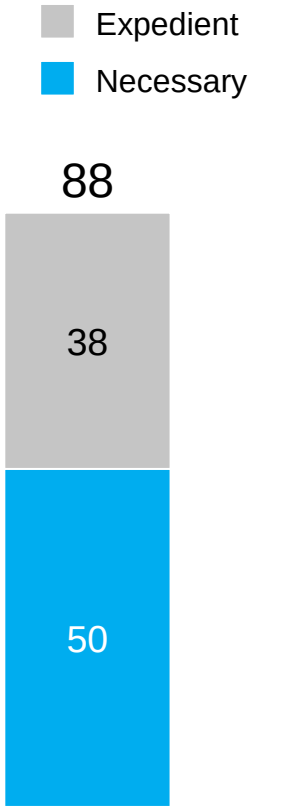
SOURCE: Noerr; McKinsey

Insolvency courts must be professionalized and consolidated – complex proceedings should have more than one judge

The figures cited below represent percentages.

xx Commercial bank employee xx Judge

The insolvency courts in Germany must be professionalised.



It is necessary to consolidate the insolvency courts in Germany.

No	14
Yes, eliminating a maximum of ½ of insolvency courts	26
Yes, eliminating at least ½ of insolvency courts	36
Yes, up to only one insolvency court per state.	20
Yes, up to only one insolvency court in Germany.	4

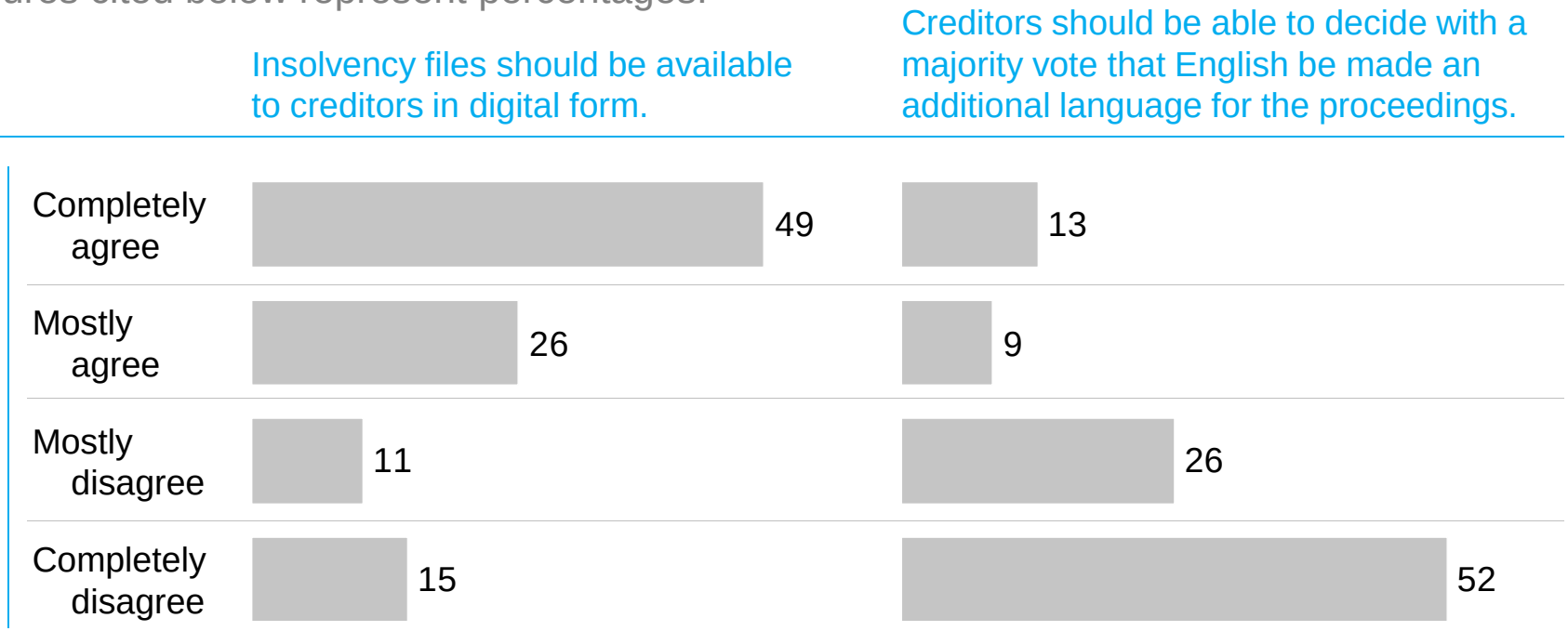
Complex insolvency proceedings should be adjudicated by more than one judge.

Completely agree	22	15
Mostly agree	31	46
Mostly disagree	16	13 15
Completely disagree	31	87 23

SOURCE: Noerr; McKinsey

Insolvency files should be available in digital form – English as additional language for proceedings not seen as necessary

The figures cited below represent percentages.



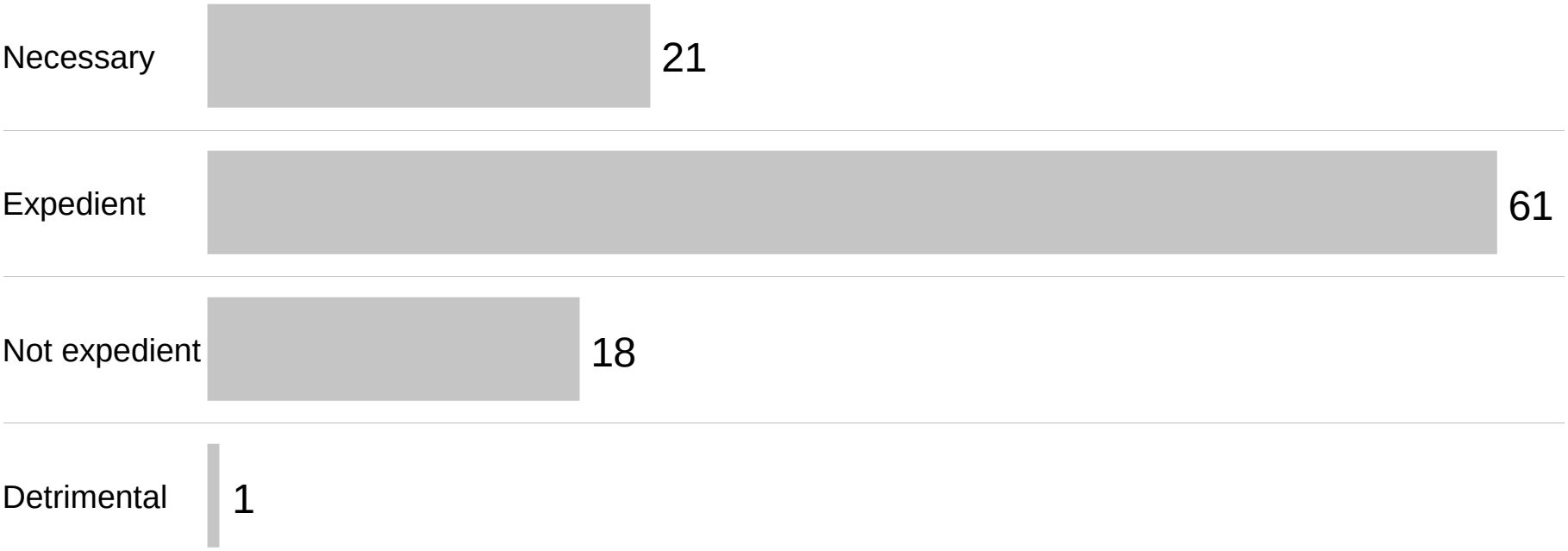
Digitalisation in insolvency law is also included in the new German federal coalition government's contract and is intended to result in more efficient and transparent proceedings, while reducing costs. The **Frankfurt am Main** Regional Court established an English-speaking commercial chamber in Jan. 2018. If one party petitions that the proceedings be conducted in English, the lawsuit is automatically to be sent to the English-speaking commercial chamber. This is intended to establish Frankfurt, especially in light of Brexit, as an international place of jurisdiction. According to a draft law in the **North Rhine-Westphalia** state legislature on March 2018, all future large commercial proceedings are to be held completely in English, up to and including the wording of the decision.

SOURCE: Noerr; McKinsey

A clear regulation on assessing the contribution value of claims in the context of a debt-equity swap is desired

The figures cited below represent percentages.

German law needs a clear regulation on assessing the contribution value of claims in the context of a debt-equity swap.

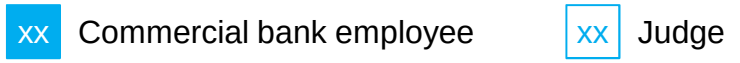


The ESUG created the option of debt-equity swaps in insolvency proceedings and loosened the prerequisites for this. However, there is no rule on how to assess the value of the claims. Possibilities include basing the assessment on the nominal value or the ratio in regular insolvency proceedings or conducting an assessment based on a positive going-concern prognosis.

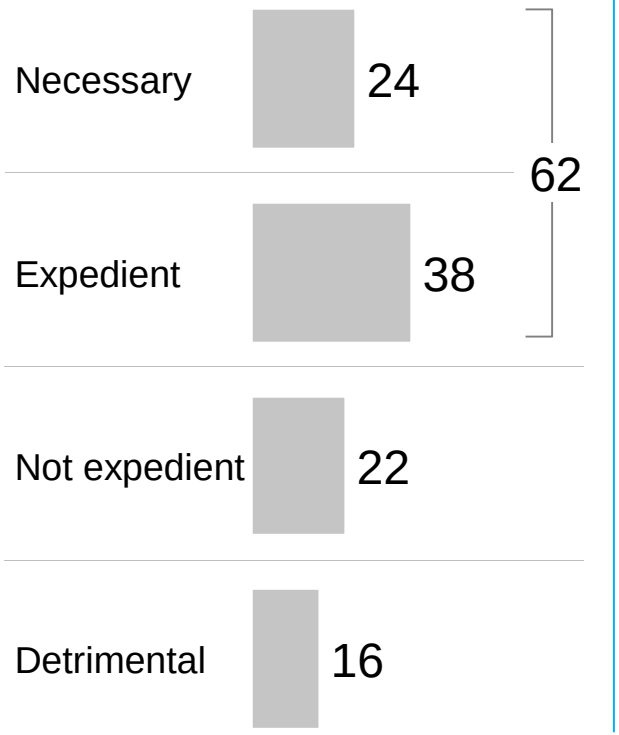
SOURCE: Noerr; McKinsey

Claw-back rules should continue to be reformed – No consensus on claw-back only in unfairness and intent deadline of four years

The figures cited below represent percentages.

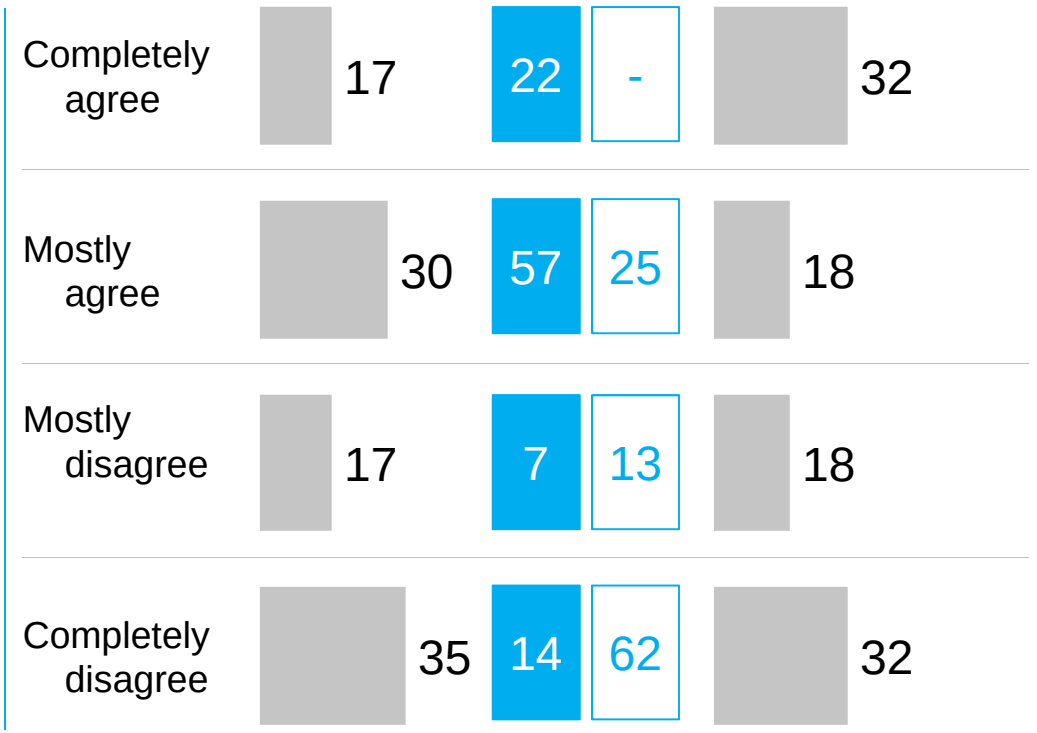


The provisions of the InsO on insolvency claw-back should be amended to place more restrictions on claw-back options.



Regardless of whether a cash transaction (Sec. 142 InsO) is involved, claw-back should only be possible in the event of unfairness.

The time limit for claw-back that intentionally harms creditors should not be more than four years.

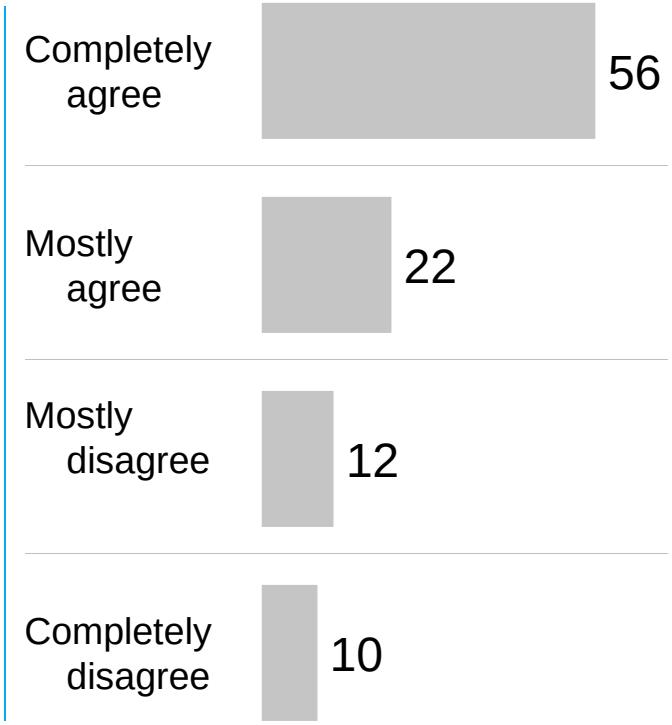


SOURCE: Noerr; McKinsey

In claw-back, the new rule on the start of the interest-bearing period precludes unnecessary waiting to assert claims

The figures cited below represent percentages.

The change in legal definition of the start of the interest-bearing period prevents insolvency administrators from waiting longer than necessary to assert insolvency claw-back claims in order to increase estate assets by the additional interest claims.



Commentary:

The new version of Sec. 143 InsO states that a monetary debt is not to bear interest after claw-back until the date on which the debtor is in default or legal action has been initiated. According to the former legal situation, interest began to accrue upon initiation of the proceedings.

The goal of the new regulation was to strengthen the legal position of the party opposing the claw-back. This goal was completely achieved.

SOURCE: Noerr; McKinsey

Contents

Summary and perspective:
Will Germany be the new restructuring hub?

- The 350 participating **experts confirm that German post-ESUG insolvency law is more attractive than it was before the changes.** The basic mood is positive, but enthusiasm is not boundless. **Remaining weaknesses** are revealed in the results of this survey.
- The most important point for the experts was the necessity of **professionalizing the German insolvency courts**. Reducing the number of insolvency courts by at least one-half was advocated by 89% of those surveyed.
- Another important point for those surveyed is the **pre-insolvency restructuring procedure**. Germany could make a good impression here by implementation before a European directive is issued.
- According to the experts, self-administration should only be an option for reliable debtors. Liability for self-administering office holders should be the same as for insolvency administrators.
- **Brexit offers Germany new opportunities**. The United Kingdom's decision to leave the EU will make the conditions for restructuring in England more difficult. German and European enterprises must look around for alternatives. Other countries, such as the Netherlands or Singapore, stand ready with their legal systems to become the new "restructuring hub".
- The **potential for improvement** derived from this survey **can provide starting points** for the assessment announced by lawmakers **to make restructuring in Germany more attractive** and to improve the basic positive mood even more.

SOURCE: Noerr; McKinsey

We are looking forward to having this conversation with you!

Noerr

McKinsey&Company

Dr Thomas Hoffmann

Partner, Co-Head of Restructuring and Insolvency

thomas.hoffmann@noerr.com

Dr Andrea Braun

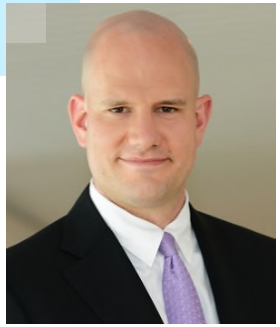
Attorney at law *(Rechtsanwältin)* and commercial transaction lawyer

andrea.braun@noerr.com

Klaus Kremers

Partner, RTS

klaus_kremers@mckinsey.com



Daniel Himmel

Sr. Vice President, RTS

daniel_himmel@mckinsey.com

Christian Wiesinger

Vice President, RTS

christian_wiesinger@mckinsey.com

Michael Becker

Associate Partner

michael_becker@mckinsey.com

Noerr

Noerr is a leading European law firm with more than 500 professionals in Germany, Europe and the USA. Its Restructuring and Insolvency Law practice group has more than 50 professionals. Noerr's comprehensive legal advice in this area is complemented by Noerr Consulting offering crisis consulting services and Team Treuhand for special tasks including as bond representatives and restructuring shareholder positions.

McKinsey&Company

McKinsey & Company is the leading top management advisory company, with around 9,000 advisors worldwide and around 1,300 advisors in Germany. RTS is a unit of McKinsey founded in 2010 that focusses exclusively on holistic transformations and restructurings. We draw on the experience of professionals from industry, private equity and the restructuring scene and link their restructuring experience with our firm's global network of experts on various sectors and positions. We work hand in hand with our clients: we advise, drive change processes in executive and line positions, negotiate with stakeholders and implement.