Varieties of Going Broke and European financial market integration

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Shawn Donnelly, University of Twente, s.donnelly@utwente.nl
David Howarth, University of Luxembourg, david.howarth@uni.lu

Abstract
One of the most important legislative developments linked to financial market integration in the European Union over the past two decades was focused on facilitating the securitization of bank assets. Securitization is also presented by the European Commission and European Central Bank as vital to deeper bond and derivative markets but also increased bank lending. However, European securitization levels have failed to recover, let alone improve, since the international financial crisis of 2007-8. Securitization requires unequivocal ownership rights to the debt contained within securitized products, and that the assets be free and clear of any further court or bankruptcy proceedings that affect the income they generate. This allows the holders to sell them on. For deeper and more liquid EU financial markets, harmonized insolvency rules across EU member states are therefore a precondition for creating a critical mass of (asset-backed) securities for institutional investors to trade. We argue that the failure to make significant progress with the harmonization of national insolvency laws owes to intergovernmental disagreement with member state government preferences rooted in national varieties of capitalism and domestic bankruptcy politics.

Keywords: European Single Market, financial market integration, securitization, insolvency law, bankruptcy law, company restructuring, capitalism (varieties of),

Introduction

In 2024, the European Commission announced its intention to relaunch the capital markets union (CMU) project, after almost a decade of near deadlock. In an attempt to increase investment in the European economy, to develop its capital markets after Brexit, and refinance banks struggling with non-performing loans, the EU continues to promote a single securitized debt market within CMU (European Commission 2020a, 2020b, Van Riet 2017). As new challenges exceed the current ability and / or willingness to expand fiscal capacity, European leaders have also turned to CMU to stimulate investment (Braun, Gabor & Hübner 2018; Tamma, Foy & Espinosa 2024). However, EU capital markets remain fragmented, capital flows outward to the United States rather than staying within the Union, a range of large European companies list on New York rather that EU-based stock exchanges, and reforms remain stalled (Martin & Asgari 2023). Why has a breakthrough remained out of reach?

Divergence in company insolvency rules is cited a major disincentive for cross-border investment decisions and CMU more generally (Valiante 216). Unlike banks, financial market investors do not have direct, in-depth knowledge of a debtor's solvency. Moreover, the heterogeneity of EU member state insolvency rules potentially encourages regulatory arbitrage. CMU plans to increase investment capital include the promotion of markets in securitized debt. Investment banks engineer securitized debt by combining a variety of bonds, mortgages and other loans held by lending banks, and sell debt packages to institutional investors that hold it as a safe, liquid, interest-bearing financial asset. Securitization allows lenders to trade long-term, risky and poorly performing financial assets for immediate cash, allows investors to trade cash or lower-return assets for higher-return assets, and supports the development of secondary markets where investors can then buy and sell securitized products as desired, making it easier for investors to manage their portfolios on an ongoing basis. By virtue of mixing low-risk, low-reward assets with high-risk, high-reward ones, the risk of default is purported to be low, provided the toxicity level of the assets is not too high. At the aggregate level of the European economy, there are major incentives to develop CMU to harness financial markets for growth, including incentivizing banks to lend more freely to business, and meeting new grand challenges that governments are unwilling or unable to fund collectively.

However, securitization requires unequivocal ownership rights to the debt contained within it, and that the assets be free and clear of any further court or bankruptcy proceedings that affect the income they generate. This allows the holders to sell them on. A degree of harmonization in insolvency rules across EU member states is therefore presented by the Commission and other supporters as a precondition for creating a critical mass of (asset-backed) securities for institutional investors to trade and for a deeper and more liquid EU corporate debt market (European Commission 2023). The creation of common standards is thus presented as essential to lower the barriers to cross-border investment and therefore contribute to a better allocation of capital. In the EU, packages of asset-backed securities tend to be limited to assets found in one or a small number of member states. We argue that intergovernmental disagreements about the harmonization of national insolvency rules rooted in domestic bankruptcy politics, national legal systems — notably corporate and labour laws — and national varieties of capitalism are a major obstacle for CMU. Most importantly, member state laws reflect major differences on the following four matters in relation to company restructuring or liquidation: creditor rights, employee rights, creditor hierarchies, which can affect the incentives to restructure companies over other options, including liquidation. More generally we contrast mechanisms that facilitate and accelerate the conclusion of bankruptcy and claims to company assets (the liberal approach), against those that invite contestation and adjudication in court (state-led and corporatist approaches). Early restructuring procedures are still not available in the majority of member states. The European Commission and a number of member state governments have encouraged improved intergovernmental coordination on national bankruptcy frameworks and the harmonization of these frameworks. They have done so for a number of reasons in addition to their hope to revive European securitization markets. Different national insolvency rules result in cost unpredictability in cross-border insolvency procedures; they undermine legal certainty in the management of nonperforming loans; they undermine the application of the EU's bank resolution rules and, in turn, the efficacity of Banking Union due to the different hierarchies of creditor claims.

Several diverging elements of member state bankruptcy frameworks have not, to date, been the subject of European Commission harmonization efforts, inter alia: difference in the priority assigned to tax claims, in the suspect period for avoidance actions, in the insolvency tests applied and the creation of specialized courts. Full harmonization is highly unlikely. However, more targeted harmonization in specific areas remains a viable option to improve market integration and notably in debt securities markets. The European Commission's proposal to harmonize the ranking of creditors under the Bank Recovery and Resolution Directive is one example of more specific harmonization efforts. The minimum harmonization on certain topics — inter alia the rules for mandatory bankruptcy filing and directors' liability — failed to create a set of legal rules that gained broad support across member states.[1]

The next section provides an overview of extant literature on CMU, including a summary of different measures taken to date to promote financial market integration, different theoretical approaches applied to explain these, and our main argument. We identify an absence of political science / political economy research linking bankruptcy and CMU which is only partially compensated by literature from legal studies. We next provide an overview of legislative developments at the EU-level. This is followed by an assessment of how bankruptcy is handled differently in three member states representing different varieties of capitalism in the EU — Ireland, France and Germany — that makes harmonization difficult on a number of levels.

Explaining (financial) market integration failure

The primary goal of the CMU project is the development of EU-based markets in financial services and products where market participants can easily buy and sell financial assets rather than having to rely upon and limit themselves to bank-based finance, and where investors can access a deep pool of financial assets to build into their portfolios. These markets comprise not only stock markets, but bond and derivative markets (which develop and trade in securitized debt), as well as the financial service infrastructure that supports trading, investment, and savings. Markets in securitized debt provide a means for traditional bank lenders to offload existing assets, and invest once again, but also for the market as a whole to attract active investment into the European economy that would otherwise be parked in other markets or savings.

The Commission's goal is to increase the supply of securitized debt created in the EU (the raw material) and its use in trading and investment (the secondary activity). Some of this debt is designed to encourage lending to SMEs (Engelen & Glasmacher 2018) rather than real estate lending, which banks and regulators consider safer investments due to the right of repossession (Donnelly 2023b). In the absence of grand changes, European initiatives have led to smaller scale changes — with, for example, the promotion by European multilateral and national development banks of SME lending supported by securitization (see Mertens & Thiemann 2018).

For a single market in securitized debt to work, a single functioning corporate bankruptcy regime is required. This requires either (1) harmonized bankruptcy proceedings (the 2024 Commission gambit); or (2) free movement of capital to any state in the Union, which national tax, company and employment laws make impossible. Companies moving headquarters

[1] By way of comparison, the original United States Constitution of 1789 contained a clause (Art. I.8.4) that allowed the creation of a federal bankruptcy law in the event that the treatment of creditors residing in different states undermined interstate commerce. However, it took almost a century for the US federal government to exercise this option demonstrating the political and legal difficulties of doing so.

normally have their assets fully taxed before the move, imposing prohibitive costs, while disparities in employee and investor rights can also stand in the way of free movement in ways that do not inhibit US companies from moving, say, to Delaware (Donnelly 2010).

Analysis of why CMU plans since 2015 have failed to reach breakthroughs emphasize political deadlocks driven by national governments concerned about losses for domestic industry (Epstein & Rhodes 2018), and competition between national governments for investment capital rather than collective action. Quaglia, Howarth & Liebe (2016) divide EU member states into promoters — the Commission, European Central Bank (ECB) and countries already involved in securitizations: notably the United Kingdom and the Netherlands — and foot-draggers with countries providing resistance that had poorly diversified financial markets, a predominance of small banks, or high reliance of industry on bank credit for external funding needs (notably Germany and southern European countries).

Gabor & Vestergaard (2018) see national competition for investment standing in the way of harmonization, with each country pursuing its own strategy and unwilling to accept regulation in those areas that disadvantage its own model. Such arguments build on a well-established body of literature focused upon a 'battle of the systems' which has hindered EU financial market integration (Story & Walter 1997). A similar dynamic was visible as EU Member States vied for UK-based business after Brexit (Donnelly 2023a). Gabor & Vestergaard also see CMU's potential undercut by the refusal of a number of member state governments to promote a greater role for the ECB as lender of last resort to support the market or to support EU measures to facilitate investment banks to take on market-making roles. For investment banks to buy and hold securities for sale, their legal status must also be harmonized and final.

The lack of progress does not stem from the lack of awareness and effort. In additional to academic work, a range of EU and national policymakers have noted the problem that different company insolvency rules in the EU create for financial market integration. Ghio et al. (2021) point to the inadequacy of the EU's harmonization language, and the limits of harmonization strategies in insolvency and restructuring law. The Eurogroup (2016) led European efforts in the 2010s to clarify best practice on corporate insolvency to encourage further harmonization. Dalhuisen (2021) argues that the harmonization of national insolvency frameworks must involve more than legal changes. He argues 'that insolvency, if properly understood, is truly an administrative measure that is, on the one hand, highly policy-oriented and, on the other hand, depends on a [considerable] degree of administrative discretion to work properly' (Dalhuisen 2021: 165). However, it is difficult to imagine many, if not most, member states governments allowing such administrative discretion in insolvency cases involving larger companies — given likely political and economic sensitivities.

A key extension of the literature exposing the intergovernmental politics of financial regulatory harmonization and the 'battle of the systems' to attract investment is that national systems persist, particularly in areas of national competence, and in areas where national regulations are reinforced by strong societal support — employee and investor rights, whether liberal, corporatist or state-led.

Theoretical Model: combining European integration theory and comparative political economy

Our argument builds on two different theories to explain failed EU level efforts to harmonize company insolvency law. First, we draw on the insights from liberal intergovernmentalism and the Europeanisation literature (focused on convergence obstacles). Neo-functionalism — and its core element of functional spill-over — fails to explain the limited progress in the harmonization of insolvency laws, although it does demonstrate why progress — albeit limited — was greatest with regard to the insolvency of cross-border companies. Liberal intergovernmentalism points to the importance of microeconomic interests in the formation of national government preferences. Clearly, business interests and trade unions in a number of member of states might prefer and seek changes to national insolvency laws but the competition of economic interests at the national (and European) levels will undermine the formation of clear member state government preferences on harmonization. It is unlikely that large microeconomic interests — outside of the financial sector in certain member states — will prioritize the harmonization of insolvency law. The financial sector in several member states — in particular those with struggling banks as in Italy — will be resolutely opposed to the harmonization of some elements of insolvency law. Liberal intergovernmentalism also points to the importance of intergovernmental negotiations which shapes the degree of cooperation and distribution of benefits. With regard to national insolvency laws, a range of differences touching on different national company and labour laws undermines effective intergovernmental bargaining. Liberal intergovernmentalism also points to limited delegation of powers to the European Commission and here national insolvency frameworks are rooted in national company and labour laws which many member states governments will be loath to restrict through European-level legislative developments. Thus liberal intergovernmentalism would predict minimum harmonization, the adoption of directives with considerable margin of manoeuvre, a preference for bottom-up best practice information sharing among member states rather than legislation and more constraining legislation only with regard to specific insolvency issues — for example, on the hierarchy of creditors for the resolution of banks.

We reinforce this liberal intergovernmentalist analysis of limited progress in harmonization with the adoption of a comparative political economy analysis which interprets national insolvency frameworks — and the company and labour law that underpins them — as a reflection of national varieties of capitalism and thus the interplay of a range of socio-economic factors that are specific to member state. Member state governments are thus reluctant to remodel specific elements of national insolvency frameworks due to harmonization demands at the EU level because these elements cannot be isolated. This may or may not reflect a 'Battle of the Systems' as in other areas of (financial) market integration. This comparative political economic analysis predicts clear limits to (financial) market integration and only limited, incremental and incomplete harmonization of national insolvency frameworks.

In terms of intergovernmental bargaining, we would expect that potential cooperation will be impeded by a small win set and low power. National varieties of going broke will thus persist, keeping overlapping national win sets low. There will be little legal room to manoeuvre to harmonize, given national competences — social rights especially — and precedents in EU secondary (company) and administrative law. We would expect a range of socio-economic actors in different countries to rally in defence of national insolvency frameworks, especially given that these frameworks reflect decades of national debate and compromise. Competing national preferences and intergovernmental bargaining will generate weak harmonization and significant variety between national systems. These national, institutional and legal differences are then kept alive by creditors, debtors and state institutions involved in living by or contesting those regulations. These rules were shaped by framing the problem of bankruptcy in company law (as a private matter — the liberal frame — or as a matter of public interest — (legacy) state-led and neo-corporatist variants — and by state strategy for regulating the economy: lightly (the liberal variant), directly (the legacy state-led variant), or indirectly (the corporatist variant) in the general public interest (Hotchkiss et al 2008; Vail, 2014). Divergent institutionalized hierarchies of rights when a company goes bankrupt, such as the treatment of creditors and potentially other stakeholders like employees, and obstacles to transferring liabilities constitute the greatest obstacles to securitization in CMU (Howarth & Quaglia 2021) and may persist despite gradual liberalization of national economies (Howarth & Hardie 2013).

These three varieties of capitalism differ not only in terms of stakeholder rights, but in terms of dominant norms regarding whether public policy should seek to prevent bankruptcy or intervene to prevent it as a matter of public interest (Hopt et al. 2005). Coordinated market economies have legal institutions designed to prevent bankruptcy through stakeholder oversight and intervention mechanisms without direct state intervention. Post-bankruptcy state intervention is seen as exceptional but depends on the presence of a strong public interest. Neo-statist market economies also value prevention and early insolvency intervention in strategic sectors, but through state-company connections that leave organized stakeholders outside the solution. Liberal market economies, in contrast, see bankruptcy as a normal event that can only be improved upon by accelerating the sale of the company's assets to other market actors, and in the case of salvaging the business through preventive restructuring, enabling a rebirth by releasing the company from legal and financial obligations.

The legal instruments and institutions discussed here include ideational constructs such as moral hazard (used to protect creditors) or corporate responsibility and fiduciary responsibilities (that protect employees, corporate clients and other stakeholders) that support national varieties of capitalism and resist European harmonization. We allow for incremental change (Streeck & Thelen 2005; Maloney & Thelen 2009) within national regulations (Hall and Soskice 2003) and contested negotiation of existing norms and rules (Fourcade et al. 2011), but expect institutionalized norms against liberalization to persist, supported by societal actors (Donnelly 2010; Falkner et al. 2024). Accordingly, we do not expect any successful socialization of governments by supranational institutions that would lead them to alter national insolvency law on the basis of existing common legal commitments (Radaelli 2000). Moreover, we do not expect successful lobbying by EU institutions and transnational coalitions to harmonize insolvency law as a way to enhance and stabilize existing institutions and practices of the Single Market (Niemann & Ioannou 2015).

Varieties of capitalism and the diversity of national insolvency regimes

To operationalize concrete differences between liberal, coordinated and (legacy) state-led varieties of capitalism we start with the liberal variant — which has been presented by some as the desirable EU standard, although this is less the case today (Banque de France 2023) — and then outline differences in the other two types. Key for liberal insolvency regimes are rules that facilitate the dismantling of the company in whole or in part. Recovery is left largely to the creditors. Auction systems are geared to the comprehensive sale of a defunct company's assets to third parties (assets are 'auctioned off') as part of closing the firm down, while reorganization codes release the company from all debts and contracts so that it can become economically viable once more. Employee rights and union participation are downplayed, while creditor rights enhanced. In state-led and coordinated market economies, in contrast, the insolvency process is highly judicialized, focused upon clearing liabilities, while closing the firm is avoided and employee interests are often emphasized. In Coordinated Market Economies

(CMEs), unions and creditor banks enjoy special legal status that protects their interests to stave off bankruptcy or manage a company's restructuring. In market economies with state-led features, government officials may intervene directly or indirectly to protect the company in the public interest, as they define it. Beyond state aid and credit guarantees, arranging takeover by a healthier firm belongs to the palate of tools that governments can deploy, sometimes requiring approval from the European Commission. Due to the privatization and deregulation of the 1980s and 1990s, the French state no longer leads business as it previously did so (Schmidt 1996; 2012), resulting in a 'post-dirigiste' state (Levy 1999, 2006; Clift 2012). The French state nonetheless has continued to intervene actively in a range of businesses and in their relationship with organized labour.

According to Hotchkiss et al. (2008), there are two kinds of bankruptcy codes in liberal systems: auction codes and reorganization codes. Auction codes support the wholesale transfer of ownership of a failed company and give the new owners sweeping rights to dispose of the company's assets as they see fit, including selling on those assets. This wholesale transfer necessitates restricting the rights of creditors and existing management, so that the new owners can recoup their investment by marking assets to market. Auctions are generally swift and legally uncomplicated in contrast to reorganization codes, given the termination of creditor rights and the finality of decision-making, allowing those who buy those assets to sell them further if desired. Auction codes work well with the securitization of corporate debt, and therefore the Commission's CMU plans, giving new owners legal certainty regarding their claims to the product. These codes are, however, dwindling in number since the 1990s, as countries increasingly deploy reorganization codes.

Reorganization codes provide management with opportunities to restructure the company and return it to profitability without shutting it down. Upon announcing insolvency, management presents a plan to creditors (and if required by law, employees) as well as the court responsible for overseeing the process and any administrator it appoints, that involves a mix of selling assets to raise money, and breaking hard contracts to reduce financial obligations, particularly employment contracts and creditor rights. Agreement between management and creditors and sometimes employees or even the state may be required. This process can take a long time as different classes of creditors negotiate the value of assets and their respective (future) payoffs rather than letting them be determined by the market.

Any bankruptcy proceeding requires asset restructuring, debt restructuring, and contract restructuring. Debt restructuring means trading existing debt for new debt at better terms. Proceeds from asset restructuring aid debt restructuring by allowing management to pay off senior creditors, and offer poorer terms to juniors, who may be left with nothing. Contract restructuring refers to legal obligations regarding wages, employment, supply chains and shareholder dividends that vary from hard obligations (wages) to soft obligations (dividends). Should these methods prove insufficient, asset restructuring involves selling off part or all of the company's assets to raise cash, either stand-alone or as securitized components. Liquid assets are the easiest to sell at full value (cash and marketable securities), followed by illiquid assets, such as mortgages (that are being regularly repaid), real estate and subsidiaries. Non-performing loans that have not yet been written down, could also be sold at a discount and also bundled into securitized products. The precise impact of insolvency and bankruptcy law relies on the spectrum of legal options available to manage insolvency, as well as the behaviour of companies, investors (creditors) and employees, as actors to decide whether and how to exercise their rights, protect their interests, and act collectively or against one another.

To map national differences we suspect to matter most, and test the argument that a range of socio-economic actors rally around existing bankruptcy practices, we examine below the national laws in place and how these lead to different claims on failing companies and approaches to their assets under conditions of financial distress. We use Ireland, France, Germany as national case studies.

To conclude, bankruptcy law in liberal member states with better developed capital markets allows for two main outcomes. First, reorganization favours corporate investors (large creditors) and salvages some corporate debt. Shareholders normally suffer more than bond holders. Second, auction models favour external investors and the securitization ecosystem, while corporate insiders lose more than in reorganization and shareholders face significant losses. Bankruptcy law in member states with CMEs, where capital markets are less well-developed, reflect several features. Notably, the continuing practice of bank-industry investment relations increases bank involvement and favours company reorganization. Where banks are more removed from company affairs, interest in reorganization declines. Powerful trade unions and labour law ensure that employee rights are protected. Bankruptcy law in member states with a tradition of greater state involvement, as in France, will provide government authorities greater margin of manoeuvre to intervene to rescue companies and / or ensure their takeover by other (nationally-headquartered) companies, while protecting employee rights.

EU-level efforts to harmonize national bankruptcy frameworks

Like many elements of the Single Market, EU involvement in bankruptcy law has been, to date, primarily focused on setting minimum standards for national legislation, courts and regulators. At the same time, these minimum standards are based on principles that can be implemented in different ways, rather than specific forms. Bankruptcy law is located within the realm of company law, which is a national responsibility, and slow to harmonize at the European level due to national differences in rules governing the relationship between companies, investors and employees, plus privileged stakeholders like blockholders or unions. The incompatibility of national bankruptcy laws is reflected in the preamble of the Council regulation of 2000, which sought to coordinate insolvency proceedings across national borders, but noted that harmonized standards were impossible given the varying rights of various stakeholders under national insolvency laws (Council 2000). In contrast to minimum standards for bankruptcy, blockholder and employee rights enjoy explicit protection under EU company law, thanks to the efforts by member state governments to preserve national diversity on these rights. The European Company Statute (Regulation 2157/2000), the Employee Participation Directive (2001/86/EC) and directives regulating the cross-border takeover of publicly-listed companies (2004/25/EC) and private ones (2005/55/EC) place very high barriers to diminishing existing blockholder or employee rights in a merger or takeover, which sometimes results from a bankruptcy.

The European Commission and several member states have, nonetheless, actively encouraged the harmonization of national insolvency rules. The Commission has proposed a number of directives and regulations and member state have accepted the development of a Swiss cheese European framework for insolvency proceedings, the scope of which is limited to the identification of the member state law to be applied, the restructuring authority (the home member state), and the procedural requirements (Valiente 2016). Efforts to encourage the convergence of national insolvency laws started with the Brussels Convention of 23 November

1995, although this did not come into force because it was not ratified by all the signatory countries. For non-financial firms, EU member states agreed the Insolvency Regulation in 2000 (Council 2000) and amended this in 2015 to apply from 2017 (Council 2015). The 2015 regulation was explicitly adopted — in part — to promote a European market in securitized debt. The member states agreed a set of broad minimum standards in 2015 to increase information about bankruptcy proceedings without changing their content: registering and supervising corporate insolvencies, protecting creditors, shareholders, and employee rights, and providing communication between courts (2015/848/EC; 2015/0283). Member states also adopted two directives in 2001 — a Credit Institutions Winding-up Directive (2001/24/EC) and an Insurance Winding-up Directive (2001/17/EC) — which provide similar measures to the regulations for financial firms (European Parliament and Council 2001).

In 2014, the Commission adopted a Recommendation on giving a second chance to debtors — including a harmonized discharge period, which differed significantly across the EU — with the aim to move away from the punitive framework in place in a number of member states towards a more 'debtor-friendly' insolvency framework, earlier restructuring procedures, and out-of-court procedures then unavailable in the majority of EU member states (European Commission 2014). There have been parallel EU-level efforts to identify optimal insolvency regimes that should guide harmonization efforts (Eurogroup 2016) and insolvency reforms were included in the European Semester's country-specific recommendations for a number of euro area member states notably with the aim of reducing high-levels of non-performing loans. In 2017, the member states agreed a new directive on preventive restructuring frameworks and insolvency procedures — amended in 2019 (European Parliament and Council 2017; 2019). The 2017 directive broached the topic of restructuring for the first time, but again confirmed a variety of national rules protecting creditors, shareholders and employees, mandating internet portals for stakeholder information (European Parliament and Council 2017).

The 2019 directive on insolvency largely followed the Commission's recommendations of 2014 and focuses upon: insolvency prevention mechanism and procedures; the formation of classes of affected parties and the adoption of restructuring plans; voting on restructuring plans by creditors and equity holders; the confirmation of restructuring plans by judicial authorities; and the discharge of debt measures allowing insolvent individual entrepreneurs to recover. The 2019 directive established a ranking of creditors — along the lines of German and American law — on the basis of an economic criterion (i.e. the quality of the claim), allowing greater flexibility in the formulation and number of classes. The directive also introduced a cross-class cram-down which enhances the position of creditors, allowing for a plan to be adopted, if the majority of classes is favour (with at least one class of secured creditors), even though the plan is opposed by one or more classes.

The 2019 directive thus addressed the legal infrastructure required for preventive restructurings and provided a broad template for coordinating national bankruptcy codes and courts (European Parliament and Council 2019). Most importantly, it set out conditions for forcing a bank restructuring over the objections of blockholders and employees. National law would be asked to consider the formation of creditor groups, allow majorities to push through agreements over the objection of minority blockholders (cram-downs), and permitted national courts a voice in restructurings that terminated the employment of 25 per cent or more of the workforce. The legal basis of the 2019 directive reflected its dual construction, based on both Article 53 (company law, as a matter of national competence) and Article 114 (internal market, a matter of EU competence).

Until 2019, European legislation did not touch upon the harmonization of member states rules on creditor rights, employee rights and creditor hierarchies, which can affect the incentives to restructure companies over other options, including liquidation. The 2019 directive potentially affected all these areas but allowed significant ongoing national room to manoeuvre and the possibility of introducing derogations (Ecole Nationale de la Magistrature 2023). EU member states bankruptcy frameworks, including preventive restructurings, continued to differ significantly. The recommended harmonization involved more or less profound changes depending on the member state.

The Commission proposed an additional directive to harmonize further elements of national insolvency rules in December 2022 — announced in September 2020 as part of the second Capital Markets Union Action Plan — but this proposal made little headway in the EU legislative process (European Commission 2022b; Lemercier 2023). The proposal aimed at harmonizing and improving certain elements of bankruptcy law, notably, amounts recovered, timeframes, the fairness and predictability of procedures. The proposed directive included a number of significant provisions: to generalize the establishment of creditors' committees throughout the EU; to require companies to request the opening of a preventive procedure before their value diminishes ('likelihood of insolvency'); to introduce a procedure for the negotiated sale of a company in the context of liquidation (long established in the United States and in place in a minority of EU member states) in which the sale of the company is organised prior to the commencement of the procedure; and a simplified regime for very small companies. In its proposed directive, the Commission completely avoided tackling several major issues — subject to ongoing disagreement among member states. These issues included, notably, a common definition of the conditions characterising the insolvency of a company and those used to standardise the hierarchy of creditors, including whether employees should be considered creditors with insolvency and representation rights in a committee of creditors, whether courts should be required to adjudicate claims, whether plans made by mandatory insolvency practitioners should prioritize continuing employment, and whether the directive should apply to small and medium-sized enterprises as well as 'micro-enterprises', as the Commission had proposed (European Parliament 2023).

There was a strong link between the 2022 draft directive and the Commission's efforts to promote securitization. The Commission released an action plan for non-performing loans in December 2020 to promote their use and sale in securitized debt packages (European Commission 2020b). To prevent a build-up of NPLs within banks and other financial institutions (primary markets), the Commission sought to promote the development of secondary markets in which these NPLs could be bought and sold by other (institutional) investors. Governments assisting troubled banks could purchase those assets as part of precautionary recapitalizations and financial support, hold them in national asset management companies and sell them later to the market (European Commission 2022a). By 2022, the EU had only reached the stage of consulting on proposed legislation to standardize information from securitization vendors to the market on such holdings (European Banking Authority 2022; European Commission 2020b) and proposing rules that ensured consumers would not be disadvantaged by the transfer of loans to another jurisdiction.

Divergence in national bankruptcy frameworks and national varieties of capitalism

Ireland

Prior to Brexit, the United Kingdom stood as the best example of a liberal market economy in the EU and its insolvency regime has long been considered the most efficient in the EU (Banque de France 2023). Ireland is examined here as the closest remaining approximation of a liberal market economy in the EU having attracted considerable international investment and company headquarters from abroad through lightened regulation and low tax rates. Like the UK, Ireland also has a comparatively efficient insolvency regime. However, the country only achieved this position recently. Its previous insolvency regime viewed all company failures as fraudulent until proven otherwise and permitted personal liability of directors even for limited liability companies. This meant a practical additional reliance on personal bankruptcy law in corporate insolvencies, coupled with high court and administrative costs (Davey 2011, Zambelli 2020). Bankruptcy procedures for large companies with a centre of main interest (COMI) or sufficient connection to in Ireland liberalized significantly in 1990 as a result of the 1988 Bankruptcy Act and subsequent changes to the Companies Act which have been updated periodically since then.

In 2021, the Companies Act was amended to allow the restructuring of small companies in the Small Companies Administrative Rescue Process. The intent was to help companies avoid liquidation and allow creditors better outcomes than liquidation would provide (Irish Tax and Customs, n.d.). Further amendments were adopted in January 2024 to expedite liquidations by splitting large and small claims (with a threshold of 2.5 million euros outstanding) between the High Court for larger cases, which had previously had sole jurisdiction, and Circuit Courts for smaller ones. Irish bankruptcy law allows for two methods of restructuring companies rather than closing them that involve changes to creditor rights: the examinership and the Part 9 scheme. The examiner is a court-appointed official for companies with a reasonable prospect of survival, who draws up restructuring plans. Although plans must be fair, equitable and approved by court, they can also be approved by a relatively low threshold favouring large creditors: representing a majority in value of one impaired class and taking advantage of a 'cross-class cramdown', which overrides objections. Examinership is widely applicable to international companies and is more liberal than either UK winding up schemes or US Chapter 11 provisions (Rynn & Ennis 2022).

The Part 9 scheme applies only to Irish companies, can be initiated by the company in distress, subject to statutory requirements, and requires a higher approval threshold — creditors representing 75 per cent of value in each class, which obviates a cross-class cram-down. The scheme places more emphasis on consensus between company and various creditor classes. Part 9 is also used for winding up (closing) companies and as in the UK, need not involve courts unless challenged by an impaired creditor (Rynn & Ennis 2022).

The overall result in Ireland remains a bifurcated system which is highly-liberalized for large and international companies on the one hand, and gradually liberalizing for small domestic companies on the other. The system for winding up domestic medium-sized companies is still largely encumbered by institutional and normative legacies that remain unchanged, while quick liquidation and auction of assets was introduced for large, international corporations more than 30 years ago, and small companies since 2022. One might expect a further liberalization for medium-sized companies to follow as arguments of punishing growing companies take root.

A further feature of Irish examinership for managing insolvency proceedings in the EU and abroad (including the European Economic Area, the UK and the US) relates to two features. First, Irish law recognizes insolvency proceedings for cross-border companies undertaken in other jurisdictions. Second, it allows restructuring of cross-border companies under the authority of the High Court and its appointed examiner for companies that fulfill the requirement of one of: COMI in Ireland; connection of an Irish and foreign parent, subsidiary or sister company in receivership elsewhere; and debtors with sufficient connection to Ireland. Where this is the case, the Irish High Court can approve the termination of contracts and the restructuring of capital (including the issuance of equity) outside Ireland (Rynn & Ennis 2022). Companies which develop a connection to Ireland can therefore appeal to the country's relatively liberal restructuring regime. Despite the country's liberal approach to restructuring, a number of leading law firms and companies call for even further liberalization, particularly regarding the treatment of special purpose vehicles (SPVs) devoted to trading in securities (Zambelli 2020).

Germany

The German insolvency framework reflects important elements of the country's coordinated market economy institutions and notably the close relations between (nonfinancial) companies, banks and trade unions. Since the 1880s, German company law has assigned banks an oversized role on company supervisory boards to promote investment and prevent company collapse. Employees (trade unions) were assigned the same role in the late 1940s. This foundation in company law is relevant to bankruptcy arrangements because the German state's strategy toward the economy and society is constitutional — setting out institutions and rights for stakeholders, but refraining from intervention after these structures have been established — and preventative in nature (*Vorsorgepflicht*), making many of the features of a reorganization code redundant. German company law protects and promotes the rights of stakeholders, including creditors, in an ex ante fashion by including them in corporate governance to prevent collapses in the first place. Banks are the most ubiquitous and active creditors. These provisions are in addition to insolvency law and differ strikingly from the approach taken in statist or liberal regimes.

Despite a gradual liberalization of German financial market law since the 1980s — promoting the use of stock markets and allowing more lightly-regulated financial services — as well as a liberalization of German corporate practices since the 1990s — non-observance of requirements for works councils in some new sectors of the economy, or in the former GDR — the normative power of stakeholder rights remains strong enough to make changes to company law politically difficult. Hard negotiations over the European Company Statute in 2001 underline strong attachment to works councils and supervisory boards as structural requirements in German companies, together with the delineation of stakeholder rights in the governance of the firm. This extends to rights to the assets of the firm, through hard contractual obligations as outlined in German insolvency law.

At the same time, the liberalization of German financial market law created space for outside investors to become corporate creditors, without the interest of participating in supervisory boards or dealing with the details of corporate governance. The change to a reorganization model in 1999 needs to be seen in light of Germany's increasing reliance on foreign investors in large companies. While Germany formally had an auction system before 1999, negotiation between various domestic stakeholders typical of a reorganization was the norm in corporate governance and company law. The introduction of a more formalized reorganization framework requiring negotiation amongst creditors coincided with the arrival of foreign investment groups in the German economy, including private equity and hedge funds with no particular investment in the continuity of German businesses, or even corporate governance.

The reorganization model delays the possibility of rapid liquidation and gives creditors incentives to negotiate over strategies for dealing with bankrupt companies with which they would not otherwise deal.

Prior to 1999, German bankruptcy law (*Insolvenzrecht*) was a form of auction system, reflecting its status as an instrument of last resort. The law shifted into the reorganization category from 1999 with the introduction of a new insolvency law (*Insolvenzordnung, InsO*). Like French insolvency law, German law encourages restructuring, both implicitly and explicitly, prioritizes the payment of taxes and the protection of employment over creditor rights. The length of time that it took German governments to adopt the 1999 law demonstrates the huge lobbying effort of German companies on the legislation and the legal and commercial complexity of reform. The 1999 law introduced the concept of 'imminent illiquidity' as a cause for opening insolvency proceedings. It applies to a debtor who is unlikely to be able to pay existing debts as they come due, and only the debtor may file a petition for this reason. The measure was introduced to enable a debtor to begin insolvency proceedings early enough to allow for company restructuring. Insolvency administrators must prepare an insolvency plan if necessary and carry out the restructuring of the debtor's business if possible. Only if restructuring is not possible, the administrator must liquidate the debtor's business and distribute the insolvency estate. The court is required to protect the debtor from actions that hurt the company's asset values until a decision has been reached.

As in France, German labour law makes it very difficult to dismiss employees. In general, the purchaser of an enterprise must assume all existing employment contracts. Employees are involved in company restructuring through works councils in negotiations over consequences for up to three weeks. Labour courts (*Arbeitsgerichte*) oversee the process regarding layoffs, and the court can decide in the absence of a works council.

However, compared to French law, the German law assigns creditors a more important role. They are assigned the power to decide whether to shut down or continue the debtor's business; to ask the insolvency administrator to draw up an insolvency plan; and even to replace the administrator. Creditor committees can be installed, but only for large companies FOLTF. These interact with the insolvency administrator, and decide by majority vote, although junior creditors are assigned no voting power.

Moreover, unlike French law, the German law provides for only one kind of rescue plan (the *Insolvenzplan*) which enables creditors to decide either to restructure a debtor's company, or liquidate it and distribute its assets, or sell it off. The insolvency plan is normally only drawn up if the debtor's company is to be restructured and parts sold off in order to finance the restructuring. If the insolvent company is to be sold, creditors are unlikely to adopt an insolvency plan. However, creditors are not assigned the power to draw up a rescue plan: only the insolvency administrator or the debtor can do so. Legal challenges, also to successor firms, have time limits from three months (normal insolvency) to ten years (for serious fraud). In anticipation of EU-level legislation — adopted in 2019 — the German government adopted a law in 2018 to allow for preventive frameworks for corporate restructurings.[2]

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[2] German legislation on preventive frameworks for corporate restructurings consists of the *Gesetz zur Fortentwicklung des Sanierungs- und Insolvenzrechts* — SanInsFoG, and *Unternehmensstabilisierungs- und Restrukturierungsgesetz* — StaRUG.

France

The French insolvency framework demonstrates important features of the state-led market economy, prioritizing the saving and restructuring of companies in financial difficulties — especially those in state-defined strategic sectors — the maintenance of employment and the repayment of creditors — in that order (Hotchkiss et al. 2008). The French framework applies a state-led reorganization procedure known as the *Redressement judiciare*. Court-appointed administrators are required to advise the court on a plan for reorganization that prioritizes the objectives noted above. Creditor rights are, in effect, downplayed. The court can unilaterally revise the terms of the companies' outstanding loans to help the company survive. Financial obligations to state institutions and employees have priority in any liquid assets made available from the sale of assets which violates notions of creditor seniority. The French bankruptcy code was reformed in 2021 following the adoption of the EU's 2019 directive to permit preventive reorganizations (Perrin & Pattin-Boggs 2021). However, apart from this change, French law was not significantly modified.

The French insolvency framework allows considerable margin of manoeuvre to local judges for the protection of employment which may lead to different approaches throughout the country. Decisions to protect employment also risk significant damage to creditors, notably from keeping alive parts of a business that could have been split and sold separately, as well as from the risk of piecemeal sales when the sale of a going concern by a company would have maximised returns for investors for a longer period of time.

The French insolvency framework permits significantly longer 'stays' than in most other EU member states. In France, stays can last for up to eighteen months, while in Germany, stays can last for only three months prior to the opening of insolvency proceedings and after the declaration of insolvency. In France — as in Spain and Italy — the state can enforce tax obligations and case expenses on a debtor's assets prior to secured creditors. In the majority of EU member states including Germany, there is no priority for tax claims.

The French insolvency framework offers two possible procedures for the companies that have requested the launch of bankruptcy proceedings: judicial administration and liquidation. Judicial administration refers to the supervision by a court-appointed administrator of the activities of a company that is in the state of cessation of payments. In this scenario, the court also appoints a supervising judge and the creditor's representative. The purpose of judicial administration is to safeguard a company, maintain its activities, protect its employees, and clear its debts. Judicial administration culminates in a court decision that usually adopts the recommendation of the court-appointed administrator on whether a company should operate under a continuation plan, be sold under a sales plan, or be liquidated. A court may appoint liquidation by which a company is wound up. A court may order the liquidation independent of judicial administration or during or at the end of the procedure. In ordering liquidation without prior administration, a court must be satisfied that a debtor is in a state of cessation of payments, that all its activities have ceased, and that it is possible to re-establish the company. Types of plans commonly used include: a continuation plan, claim filing for creditors, and sale as an ongoing concern. First, if there is the real possibility that a company will recover economically and pay its debts in accordance with a repayment schedule agreed by its creditors, the court may choose a continuation plan. Plan preparation, which proceeds presentation and analysis by the court, usually takes at least six months because it first requires that claims owed to creditors be appraised accurately. Second, domestic and foreign creditors are granted two and four months respectively from the publication of the bankruptcy judgment to file a claim.

Third, if it is unlikely that a company in its existing form will recover but the company can be sold as an ongoing concern — either whole or as several distinct but autonomous units — then the court usually chooses a sales plan. The goal of a sales plan is to preserve as much of the company and its employees as possible and to repay its creditors, in that order. Parts of the company that are not included in the sales plan are liquidated, and the remaining shell of the company is wound up. A sales plan can usually be prepared more quickly than a continuation plan because it does not depend on the amounts owed to creditors. It essentially requires a thorough review of the assets and contracts, including employment agreements that are relevant to the buyer and, in some instances, negotiations with some of the main suppliers, clients, and/or secured creditors. Therefore, two of the most used options in French insolvency law involve company restructuring with minimal job loss. Whichever plan is adopted, the involvement of a company's creditors is marginalised. They are usually informed of the insolvency by the creditors' representative in a standard letter and invited to file proof of debt. French law does not provide for creditor meetings or creditor approval.

The French government is officially in favour of further harmonization of EU member state insolvency laws. Liberal intergovernmentalism points to the central role of France and German of reaching compromises to promote European market integration. Indeed, harmonization in EU member state insolvency laws could be achieved through Franco-German efforts to serve as a vanguard. The Association Henri Capitant sought to promote these efforts based on French and German law and in 2021 produced a draft legislative proposal (Association Henri Capitant 2021). However, no formal progress in bilateral Franco-German legislative harmonization has yet been officially achieved.

Conclusion

EU capital markets remain fragmented and major reforms are stalled (Martin & Asgari 2023). Divergence in company insolvency rules is cited as a major disincentive for the relaunch of securitization in the EU, cross-border investment decisions and CMU more generally (Valiante 216). CMU plans to increase investment capital include the promotion of markets in securitized debt. The incentives are high to develop CMU to harness financial markets for growth, including incentivizing banks to lend more freely to companies. A degree of harmonization in insolvency rules across EU member states is presented by the European Commission and other supporters as a precondition for creating a critical mass of (asset-backed) securities for institutional investors to trade and for a deeper and more liquid EU corporate debt market (European Commission 2023).

Applying both liberal intergovernmentalism and a comparative political economy analysis of national insolvency regimes, we have argued in this paper that intergovernmental disagreements about the harmonization of national insolvency rules rooted in domestic bankruptcy politics, national legal systems — notably company and labour laws — and national varieties of capitalism are major obstacles for financial market integration. We have contrasted mechanisms that facilitate and accelerate the conclusion of bankruptcy and claims to company assets — the liberal approach — against those that invite contestation and adjudication in court and protect employees and / or domestic bank interests — state-led and corporatist approaches. Early restructuring procedures are still not available in the majority of member states. National insolvency frameworks reflect major differences on creditor rights, employee rights, creditor hierarchies, which can affect the incentives to restructure companies over other options, including liquidation. A liberal framework in Ireland exists that could be applied to any European company with an Irish connection, but cannot overcome restrictions maintained in other member states.

Our analysis suggests that entrenched national insolvency frameworks are only likely to shift gradually over time through encouraged emulation. Indeed, the findings of our analysis parallel those of Ghio et al. (2021: 450-51) who critically examine the Commission harmonization efforts and suggest ways to better coordinate these efforts. In addition to top-down EU institutional efforts, they argue in favour of more best practice information sharing and bottom-up national solutions with member states acting as drivers of European harmonization.

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