



INSOL
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MSMEs - PRACTICAL CHALLENGES AND RISK MITIGATION POST COVID-19



INSOL INTERNATIONAL

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PRESIDENT'S INTRODUCTION

The World Bank has estimated that micro, small and medium sized enterprises (MSMEs) represent over 95% of enterprises and account for more than 60% of employment worldwide. With limitations regarding their ability to self-protect against insolvency risk, their susceptibility to systemic demand and supply shocks, their limited capital reserves and their level of debt overhang, MSMEs are in a vulnerable predicament as government fiscal and insolvency relief measures are wound back and the world endures difficult economic circumstances and tightened monetary policy measures.

This new publication from INSOL International, *MSMEs - Practical Challenges and Risk Mitigation Post Covid-19*, provides a timely overview of the informal, hybrid and formal restructuring and insolvency options available to MSMEs in the event of financial distress in 29 jurisdictions across the world. It also outlines the interim measures adopted by governments in those jurisdictions during the pandemic, and assesses the success of those measures in preserving the financial stability of MSMEs and maximising the prospect of a successful restructuring.

Each of the 29 chapters also provides an update on the latest insolvency reform measures either introduced or contemplated to provide streamlined restructuring and insolvency alternatives for MSMEs. This is especially important, with INSOL, the World Bank and UNCITRAL having identified the need for bespoke MSME processes beyond the "one size fits all" formal insolvency alternatives that are generally suited for larger enterprises.

Ultimately, given MSMEs' contribution to domestic, regional and global GDP and employment, creating flexible, efficient and cost-effective restructuring and insolvency alternatives for MSMEs is critical to ensure broader economic and financial stability, job maintenance, innovation and growth in our global economy.

Following the introduction of MSME restructuring and insolvency alternatives in the United States, Myanmar, Singapore, India and Australia in the last several years, it is hoped that similar measures will be introduced in other regions as we continue to navigate current economic conditions.

This book will provide a valuable contribution to our members worldwide, and will serve as a foundation to support ongoing law and policy reform and capacity building in coming years.

INSOL thanks each of the contributors from the 29 jurisdictions covered in this book, as well as the leader of this project, Rocky Gupta, INSOL Fellow, of UNITEDJURIS, India for committing their time, energy and expertise to ensure the completion of this book.

I hope you enjoy reading this excellent resource.



Scott Atkins

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FOREWORD

This is a special INSOL International publication which explores the insolvency frameworks and special insolvency procedures that exist for MSMEs in 29 jurisdictions worldwide. The publication also provides an overview of the interim fiscal stimulus and insolvency relief measures that were introduced during COVID-19 and the systemic challenges that MSMEs face – such as access to new money and the stigma associated with insolvency – in attempting to restructure their affairs.

Across these 29 jurisdictions, this book concentrates on the diverse tools available to facilitate the reorganisation and restructuring of MSMEs and the possible best solutions and strategies for economic distress alleviation. One of those tools, mediation, is a particular focus point and this book assesses the effectiveness of mediation as a viable restructuring tool.

For each jurisdiction, the book also includes feedback from experienced practitioners on what they see as being the best way to safeguard the interests of MSMEs and whether simplified processes exclusively for MSMEs would enhance the likelihood of a successful restructuring.

The idea of this project came in mid-2020 when the pandemic was at its peak and many businesses and companies had started getting into financial and operational distress. This was not a local phenomenon, but a global one. MSMEs, being one of the major contributors to GDP and collectively constituting almost 90% of the businesses in most jurisdictions, were facing the full impact of the pandemic.

I hope that this book will be a valuable tool for practitioners, academics and the judiciary across the world and may serve as the basis for future law reform locally, regionally and globally.

This project would not have been possible without the help and support of a team of professionals associated with this project. The initial acknowledgement must however go to the Technical Research Committee of INSOL International and Dr Sonali Abeyratne, Dr Kai Luck and Ms Waheeda Lafir in particular for all their assistance throughout the completion of the project, and of course to all the chapter contributors to the book globally for their time, expertise and commitment.



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1. Insolvency Framework - General Overview

1.1 Formal insolvency legislation

In Nigeria, the Companies and Allied Matters Act 2020 (CAMA) is the regulatory framework on formal insolvency for corporate entities and vehicles. CAMA is new law that came into force on 1 January 2021. On the other hand, the Bankruptcy Act 1979 (BA) deals with individual persons and persons trading under a business name. The BA provides that a receiving order shall not be made against any corporation or against any association or company incorporated under the CAMA. However, depending on the circumstances of the individual trading under a business name, one would have the option of either initiating a bankruptcy proceeding against the individual (particularly where a personal guarantee has been provided) or proceeding under the administrative process in Part E of the CAMA (discussed below).

Nigeria classifies businesses into micro, small and medium (MSMEs and SMEs). Any business enterprise employing less than 10 workers and having an asset base of less than N 5 million is regarded as a micro enterprise. The employment base for small scale enterprises is set between 10 and 49 employees with an asset base of over N 5 million and less than N 50 million. Medium scale enterprises are those that employ between 50 and 199 workers, with an asset base of over N 50 million and less than N 500 million. MSMEs constitute around 80% of Nigerian businesses. They have contributed about 48% of the national GDP in the last five years and account for around 84% of employment. Remarkably, many MSMEs and SMEs are in the informal sector with registered business names, rather than being companies limited by shares. This explains some of the innovations under the CAMA, such as the creation of single shareholding limited companies and limited partnerships (LPs).

Part E of the CAMA provides for the registration of a business name carried on by an individual, firm or corporation and the removal of the name from the register by the Registrar of the Corporate Affairs Commission in certain cases. Importantly, the Registrar may, upon reasonable cause and in the absence of an answer to a notice on whether the individual, firm or corporation has ceased to do business, remove the business name from the register within two months from the date notice for an answer is provided.

Part C of the CAMA provides for the incorporation of limited liability partnership (LLPs) as a separate legal entity from the partners. The liabilities of a LLP must be met out of the property of the LLP and a partner is not personally liable, directly or indirectly, for an obligation of the LLP (contractual or otherwise) solely by reason of being a partner of the LLP, except in the case of fraud. A LLP may be wound up either voluntarily or by the court on various grounds, including if the LLP is unable to pay its debts. There are similar provisions for LPs.

Part B (Chapter 25) of the CAMA also provides for the winding up of unregistered companies if the company is dissolved, has ceased to carry on business (or is carrying on business only for the purpose of winding up its affairs), is unable to pay its debts, or if the court is otherwise of the opinion that it is just and equitable that the company should be wound up. An unregistered company extends to an exempted foreign company, partnership or association (each of which must

ordinarily be registered under the CAMA in order to be allowed to do business in Nigeria).

1.2 Specific insolvency legislation

There is no specific insolvency legislation for MSMEs in Nigeria. However, professional bodies such as the Business Recovery and Insolvency Professionals of Nigeria (BRIPAN, which has contributed substantially towards the reform of the Nigerian insolvency framework) and more recently the Nigerian Bar Association Section on Business Law (NBA-SBL), are engaging with the Corporate Affairs Commission and the Presidential Enabling Business Environment Council (PEBEC) to encourage a MSME-specific insolvency process. These efforts have also been pursued with policy makers such as the World Bank and INSOL International.

1.3 Framework for out of court assistance or workouts

1.3.1 Formal framework

Prior to the adoption of the CAMA, practitioners and commercially-oriented judges had been using the instrumentality of court-ordered alternative dispute resolution (ADR) to promote out of court assistance or workouts (OCWs). A limitation of that process is that it is time bound to a period of 30 days.

CAMA formally introduced new options for rescuing or restructuring financially distressed companies, such as company voluntary arrangement (CVA) and administration. Embedded in these procedures (without prejudice to certain rules such as preferential payments, subject to court sanction or exceptional intervention power) is a tacit acknowledgment of OCWs, including pre-pack administration procedures between the company and its creditors.

There is no formal framework for personal or individual insolvency *per se*, particularly as efforts are still ongoing to repeal the antiquated BA. However, in certain cases relating to non-performing loans sold to the Asset Management Corporation of Nigeria (AMCON), the earlier mentioned statutory powers of the court to direct the parties to ADR, and the AMCON Practice Direction, are tools available to encourage an OCW.

1.3.2 Informal framework

As noted, the introduction of new procedures under the CAMA acknowledges the relevance of OCWs and now potentially is paving the way for debtors to use their initiative to make proposals for a workout – including through the use of a pre-pack. These developments are encouraging greater flexibility and creativity and a more habitual use of tools such as negotiation and mediation in multi stakeholders workouts and a de-escalation of a litigious “race to collect” approach.

1.4 Accelerated restructuring or liquidation of MSMEs

There is no specific mechanism for accelerated restructuring or liquidation of MSMEs in Nigeria. As identified above, the new procedures introduced under the CAMA apply to all companies generally and are not MSME-specific.

1.5 Discharge of debts for natural persons

Although the BA¹ provides for an unconditional order of discharge of the bankrupt upon application (except if the Official Receiver reports to the court any fact, matter or circumstance which would justify the court in refusing an unconditional order of discharge), the reality is that various other provisions of the BA militate against an effective discharge of debts by natural persons. First, an order of discharge does not release the debtor from certain creditors' claims (State or court related debts, sanctions, penalties, bail bond, liability arising from a fraud or fraudulent breach of trust to which the debtor was a party, including where the creditors involved assented to a scheme of arrangement with the debtor). The BA also provides for a plethora of conditions to be met before a court can grant an effective discharge.²

1.6 Extended or suspended repayment terms for MSMEs during the pandemic

The Central Bank of Nigeria (CBN) in its circular dated 23 March 2020 stipulated the guidelines for the implementation of a N 50 billion targeted credit facility to support households and MSMEs with verifiable evidence of being adversely affected by the COVID-19 pandemic as well as enterprises with bankable plans. The guidelines also provided at the time for a three month moratorium period being granted for all government funded loans. Some other aspects of these key policy measures included:

- a one year moratorium on all principal repayments;
- an interest rate reduction on intervention facilities from 9% to 5%; and
- the loan limit for SMEs under the scheme was a maximum of N 25 million (and N 3 million for households), with both at an interest rate of 5% per annum (all inclusive) up to 28 February 2021, and thereafter 9% per annum (all inclusive).

2. Special Measures

2.1 Procedural insolvency measures with respect to MSMEs

No special insolvency measures or specific insolvency rules have been introduced for the simplification of proceedings for MSMEs during COVID-19 in Nigeria, whether under the corporate or personal insolvency framework.

2.2 Suspending the requirement to initiate insolvency / liquidation proceedings

No special measures were introduced during the pandemic suspending the requirement to initiate insolvency or liquidation proceedings, other than the general requirements and suspension features available under the new procedures introduced by CAMA 2020 during the pandemic.

¹ BA, s 103.

² *Idem*, ss 28(4), 28(10) and 29.

2.3 Insolvency procedural deadlines

No specific measures were introduced during COVID-19 extending insolvency procedural deadlines. However, some regulators extended timelines for various return actions, which MSMEs were able to benefit from.

For example, the Lagos State Internal Revenue Service (LIRS) extended the deadline for filing annual tax returns for employees and self-employed persons by two months from 31 March 2020. These measures assisted in mitigating the financial impact of the pandemic on MSMEs.

2.4 Minimum debt requirements to initiate insolvency proceedings

During COVID-19, the relevant minimum debt requirement initially remained as provided under the relevant CAMA and Bankruptcy Laws.

However, in August 2020, the threshold was generally increased and became effective by 1 January 2021. Under CAMA, a company may be wound up by the court if the company is unable to pay its debts in a sum exceeding N 200,000, while the BA (which is yet to be reformed) remains at N 2000.

2.5 Suspending specific creditors' rights

No measures were introduced during COVID-19 suspending specific creditors' rights to initiate insolvency proceedings. The relevant general moratorium provisions introduced with the new CAMA law remained in place.

2.6 Mediation and / or debt counselling

Mediation and debt counselling for the rescue, restructuring or rehabilitation of MSMEs was generally absent prior to the CAMA.

However, since the CAMA entered into force in January 2021, in practice many entities have been exploring debt counselling and have sought for experts retained to engage in informal discussions with critical stakeholder creditors to achieve informal arrangements.

Some of the existing ADR provisions in court procedural rules also enjoin out of court dispute resolution. The ADR approach may also be taken advantage of at the onset of cases in court. Generally, the State High Court Civil Procedure Rules provide for a mandatory pre-action protocol confirming the parties have explored amicable settlement of the issues by way of mediation prior to the commencement of the suit. MSMEs are expected to comply with that requirement, and to explore mediation with a view to rescue or restructure the business and avoid litigation. In addition, Multi Door Courthouses attached to the courts are available to further mediate and counsel parties to foster amicable settlement. However, there is no such mandatory requirement at the Federal High Court to initiate any mediation or debt counselling prior to commencement of any formal insolvency proceeding – and it is in the Federal High Court that insolvency procedures are usually commenced.

Nevertheless, the Court still has powers to give directions for ADR inclusive of mediation for a given period before the parties are returned for a formal dispute resolution.

Making mediation and debt counselling mandatory in a pre-insolvency scenario would be meritorious. This would promote business rescue / continuity, time and cost efficiency and ultimately greater value for creditors rather than a liquidation or receivership scenario. This approach should only be avoided where there is clear evidence of fraud and elements of criminality, particularly from the directors or alter egos of the MSME.

The impact of the new provisions in the CAMA, such as CVA and administration, is already changing the landscape of insolvency practice in Nigeria as debtor companies and entrepreneurs – with the support of restructuring practitioners – have found a window of engagement with creditors pre-formal insolvency. We are beginning to witness a paradigm change and a less toxic environment for business rescue and insolvency practice.

Mediation can help MSMEs cut time and costs pertaining to restructuring and formal insolvency. This is critical for MSMEs to thrive as doing business in Nigeria is at times challenging given the paucity of infrastructure, and substandard energy supply.

That said, the absence of any protective moratorium / coercive effect on stakeholder creditors (i.e. buy in by all is required) is a limitation on the use of mediation.

3. Challenges Faced

3.1 Stigma associated with insolvency

There is a strong stigma in Nigeria attached to an individual who is adjudged bankrupt, and bankruptcy extends to disqualification from certain political office. This in part explains a cultural resistance to the cumbersome and rescue unfriendly BA in Nigeria. Having regard to the fact that the identity and personality of the promoter / alter ego of a MSME is closely linked and connected to the business itself, and that personal security usually features for facilities taken by MSMEs, the reputation of the promoter is likely to take hit where it is found out that the business is insolvent.

The publicity associated with formal insolvency procedures (which before 2021 were purely liquidation-oriented), and special insolvency regimes such as receiverships under the AMCON Act, expose promoters, directors, key shareholders and alter egos to public odium and condemnation for alleged mismanagement or fraud. There is also the impact of a debtor's credit standing since the advent of the Credit Reporting Act in 2017 – which may inhibit the ability of the entrepreneur to access new finance from financial institutions. Where a MSME fails and is wound up, the promoter will find it difficult to promote another MSME in the same industry or region, as both investors, financial institutions and customers will not confer the new MSME with much business credibility.

3.2 Availability of financial information

Without prejudice to the implementation of CAMA, a large percentage of MSMEs in Nigeria operate in the informal sector and do not keep or have proper and accurate financial information. The business is also often run outside the formal banking system, thereby making it difficult, if not impossible, to obtain and verify the accurate financial information and standing of MSMEs.

Where the MSME is a trade by a natural person, it is even more difficult to have access to the financial information of the MSME, and there is usually no separation of the individual and the business account. Notwithstanding, personal income tax laws require natural persons to conduct a self-assessment and file a return of income. So, it is possible that the financial information be within the custody of tax authorities, although tax compliance by self-employed persons is extremely low in Nigeria.

Government efforts are ongoing to improve financial literacy among MSMEs, including migration from the informal to the formal sector through public enlightenment and offer of tax incentives. A migrated MSME business is mandated to file returns with tax authorities and the Corporate Affairs Commission (CAC). It is hoped that access to financial information and data on MSMEs in Nigeria will improve and assist in legislative reform.

3.3 Access to new money

Generally, interim or new finance or post-commencement finance (PCF) is not readily available in Nigeria. However, this seems to be a nascent market, particularly with some of the government initiatives through the CBN noted earlier (which appear to have come to stay). There are a few other targeted intervention funds initiatives from the government in certain sectors through development banks. The introduction of the CVA and administration also lend credence to this, particularly as the provisions on administration specifically acknowledge the possibility of PCF. Also, the concept of distressed financing is not alien to the Nigerian corporate industry.

Notwithstanding, PCF for business rescue promotion purposes would not have priority over existing secured claims, except in the context of an arrangement and with the consent of existing secured and preferential creditors.

3.4 Secured creditors *vis-a-vis* unsecured creditors

While there is no special regime for MSME insolvency in Nigeria, the general insolvency regime can be applied to MSMEs.

Generally, secured (proprietary, appropriating or possessory interest) creditors in formal insolvency proceedings enjoy primacy over and above unsecured creditors. For example, secured creditors can do the following:

- take possession of secured assets;
- appoint a receiver / manager over the assets of the MSME where empowered by the agreement or seek the order of the court;

- exercise the right of sale over the secured asset; or
- sue for foreclosure (in the case of a mortgage).

However, the holders of a floating charge are not secured creditors within the strict meaning of that term under the Nigerian legislation. While the claims of secured creditors – particularly in a liquidation – shall rank in priority over all other claims (including insolvency costs and expenses and preferential payments), floating charge holders come after preferential creditors.

Also, the rights of secured creditors to enforce their rights / security cannot be modified via a CVA or administration process except with the concurrence of the secured creditor, or in certain cases the Administration Court.

3.5 Insufficient asset base

As noted, there is no MSME-specific formal insolvency regime in Nigeria. The low asset base of MSMEs would, accordingly, impact on the ability to fund the formal process of insolvency by way of a CVA or administration (which in Nigeria operates in the same manner, with the same costs and time requirements, for all companies) for MSMEs. However, this may also present more opportunities for funding informal processes of insolvency, provided there is clear economic prospect found in the business.

3.6 Personal guarantees (PGs)

As earlier stated, PGs are prevalent in Nigeria, particularly for MSMEs, as they serve as an additional layer of security for high cash and low asset-based businesses.

Therefore, upon the default of a MSME, a counterparty to the loan transaction can have resort against the personal guarantor.

There is no general or coordinated procedure or structure provided in any law or regulation that governs the enforcement of a PG in Nigeria. Rather, PGs are enforced in line with the terms, provisions and conditions stated in the agreement of the parties. The general civil procedures (whether fast tracked or not or brought under summary or undefended procedures as the case may be) for enforcement of contracts are applicable to PG enforcement.

3.7 Further challenges

Financial illiteracy of owners of MSMEs, as well as a sound commercial understanding of business rescue and insolvency, are challenges which are being worked on in Nigeria through legislative reform. Government incentives to keep proper books and financial transparency while running MSME businesses, as well as capacity building (particularly for the judiciary), are works in progress.

4. Moving Ahead

4.1 Best way to safeguard the interests of MSMEs

Our recent engagements with regulators, judges and insolvency practitioners at

the BRIPAN Annual Conference held on 23 and 24 September 2021 revealed that deference to and appointment of turnaround advisers and restructuring practitioners – both for internal advice and engagement with creditors – and the use of formal or informal CVA frameworks to achieve a consensual and business rescue approach in the best interest of the business, would be the best way to safeguard the interests of MSMEs. This is because the informal workout culture is not very strong and the minimal role of the court in the context of a CVA (along with the critical role of the insolvency practitioner) has created a favourable impression among MSMEs that a director / company initiated CVA is not really a formal procedure but more of a process done in the shadow of the court.

This was also the opinion of judges, who deferred to turnaround practitioners' expertise, reports and dealings outside the court.

4.2 Has formal insolvency helped MSMEs or created more stress for MSMEs?

Formal insolvency procedures in Nigeria prior to the CAMA have been unfriendly and unhelpful to MSMEs for the purpose of business continuity, and the pandemic exacerbated these issues. However, the introduction of the CVA (being executed in the shadow of the law by turnaround practitioners without displacing the debtor's management) and administration has had the inverse effect and is leading to a paradigm shift, and greater communications and engagements between the debtor (and their insolvency practitioner) and creditors in an orderly manner.

Practitioners have over the years observed that financial literacy is key among MSMEs, and experts who may be appointed by the debtor owner of the business are key to bridge that gap and create the requisite atmosphere of confidence and credibility between the debtor and creditors for the purpose of business rescue.

However, overall the formal framework remains generic and is not well customised for MSMEs with simplified procedures.

There has virtually been no post-COVID legislation or subordinate legislation specifically or even generally targeted at improving the lot of MSMEs. The promulgation of Insolvency Regulations in April 2022 - to complement the substantive laws on business rescue - are generic in nature as well.

4.3 Simplified insolvency proceedings

There is no simplified insolvency or restructuring procedure for MSMEs distinct from the present mechanism in the Nigerian jurisdiction. Indeed, the newly introduced procedures of CVA and administration do not boast of any subordinate procedural rules to implement them, unlike the liquidation rules. Accordingly, the process is not a simplified process but one currently guided by the discretion or interpretation of the courts to cover the field.

The majority of the insolvency mechanisms available in Nigeria require a certain minimum or maximum level of court involvement and / or approvals which may cause delay and congestion of the court's docket. Ancillary to this is the cost of engaging legal practitioners and insolvency practitioners to push the process.

Considering the above, it is expedient to establish a simplified insolvency framework that is flexible and broad enough to address the insolvency challenges faced by MSMEs. A simplified insolvency framework which provides alternatives to a full formal court proceeding, such as mediation and arbitration, would reduce the number of steps, requirements and documentation, and address the peculiarities of MSMEs during insolvency in Nigeria. This would go a long way in increasing the number, lifespan and viability of MSMEs in Nigeria.

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