The Criteria for Determining the Business Failure

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Abstract: The business failure represents a current problem in any economic and social context and, for this reason, the legislator has been concerned with the regulation of the criteria based on which to accurately determine the failure of a business man when the case. The liquidity test and the balance sheet test, or the insolvency and insolvability are the criteria for determining the business failure usually materialized by undergoing the bankruptcy procedure. The legislator's option for one or another of these criteria represents a structural option depending on the legal culture of each state however, considering the economic causes and effects of the insolvability and insolvency, that tends to remove the unilateral, exclusivist options. This paper illustrates significant option differences between the criteria for determining the business failure in the member states of the European Union, which is the most used criterion and, if these criteria can be equally used in the banking and insurance sector. Last but not least, the paper illustrates the meanings of insolvency and insolvability in different matters and different laws and the need to eliminate the reserve that the Romanian doctrine manifests towards the insolvability concept as a cause for bankruptcy.

Keywords: insolvability; insolvency; liquidity test; balance sheet test; bank; insurance undertaking

1. Introduction

1.1. The evolution of the business failure conception has determined the transformation of this phrase from an economic concept, into a legal concept as substitute for the bankruptcy notion, considered as having negative and sensitive connotations.

For determining the business failure, as a cause for bankruptcy, there are used two different criteria: i) the available funds (liquidities) test, i.e the capacity to pay the

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debts upon their maturity; ii) the balance sheet test, i.e. the surplus of liabilities by reference to the assets, insolvency and insolvability.

The available funds (liquidities) test is the one indicating the existence of insolvency state and the balance sheet test determines the existence of the insolvability state, provided that the business has failed in both situations.

We will further analyze the causes for the business failure and for the bankruptcy, from the perspective of both these notions: insolvency and insolvability, considering the meaning of such notions, as provided in the general and special corporate law.

We intend to establish whether there are significant option differences between the criteria for determining the business failure in the member states of the European Union, which is the most used criterion and if such criteria can be equally used in the banking and insurance sector. And, last but not least, we will illustrate the meanings of insolvency and insolvability in different matters and different laws and the need to eliminate the reserve that the Romanian doctrine manifests towards the insolvability concept as a cause for bankruptcy.

2. Conceptual Disclaimer

2.1. The general bankruptcy cause for any trade company regulated under the Romanian law is the state of insolvency, the stoppage of payments, the lack of available funds, of available amounts for paying the outstanding debts (Cărpenaru, 2001, pp. 733- 734; Turcu, 2000, pp. 193; Ripert et al. 2000, pp.836; Guyon, 1999, pp. 132) no collective procedure being opened before the moment of payments stoppage.

The difficulty of adapting the legal definition of insolvency as regulated under the substantive law to credit institutions, respectively to banks, has determined the specific approach of banking insolvency.

Thus, Government Ordinance no. 10 on 2004 regarding the failure of credit institutions[1], the special Romanian regulation of banks' failure, establishes as bankruptcy cause for this special commercial companies, the generic insolvency

[1] Romanian law - Government Ordinance no. 10 on 22.01.2004 on the credit institutions failure, Of. Gazette., Part I, no. 85 on 30.01.2004.

state, by indicating three distinct categories or forms of bank insolvency, representing the same number of special causes for banks' failure:

(i) *Obvious incapacity to pay the due debts from cash available funds;*

(ii) *The decrease under 2% of the credit institution solvency ratio;*

(iii) *The withdrawal of the credit institution working authorization, in accordance to the legal provisions, due to the inability of financial recovery of a credit institution.*

Beyond these considerations, the three categories of banking insolvency, the causes for bank failure maintain their individuality, thus we will further analyse it individually.

Moreover, for avoiding any confusion and for the clarity of presentation, we will indicate the causes of banks failure by the use of their economic significance: liquidity crisis, solvency crisis and the bank's impossibility to financially recover.

At the insurance companies, the essential indicator of the financial stability of the insurance companies: their solvency, determines the substantial amendment of the background conditions of the application of the insurer's bankruptcy procedure as compared to those imposed for the initiation of the bankruptcy procedure of the regular trading companies, regulated by Law no. 85/2006 on insolvency, even if the main general coordinated are maintained: the *condition on the debtor's capacity and the one related to the financial state hereof, the insolvency state, as well as the bankruptcy procedure initiation cause* (Ripert et al. 2000, pp. 836; Guyon, 1999, pp. 109).

As regards the condition on the financial situation of the insurance company, it should be in an insolvency state, genre concept including three particular causes of the application of the procedure to these special entities.

In fact, the solvency of the insurance company indicates the insurer's capacity to cover the unexpected losses.

According to the law no. 503/2004 regarding the restoration and the bankruptcy of the insurance undertakings, the insolvency state is that state of the insurance company characterized by one of the following situations:

i) obvious incapacity of payment of the due debts using the available funds;

ii) decrease of the value of the available solvency margin below half the minimal limit stipulated by the applicable legal regulations for the security fund;

iii) Impossibility of recovery of the financial situation of the insurance company within the financial recovery procedure (art. 3 letter j in Law no. 503/2004).

All these situations constitute manifestation forms of the insurer's insolvency, particular cause of initiation of the bankruptcy procedure (Catana, 2007, pp. 87).

2.2. In the national systems of the EU member states and of the European economic area there are major differences in approaching the problematic of the business failure criteria.

A short presentation of such differences, in few of the member states of the European Union, shows the tendency of accepting, within the frame of the same legislative system, of both insolvability and insolvency, as causes for both business failure, as well as of bankruptcy.

In France, "cessation of payments" (cessation des paiements) is the main cause (Ripert et al. 2000, pp. 855) for applying the procedure for legal redress and dissolution[1].

The meaning of the notion: debtor under cessation of payments represents the inability of the debtor to cover the liabilities from the due or available assets ("s'il est dans l'impossibilite de faire face a son passif exigible avec son actif disponible" – art.88 of the Law no. 2005-845 in July 26th, 2005) according to the definition under art. L. 631-1 of the C.com.fr., definition used also in the Ordinance no. 2008-1345 / December 18th 2008[2] (Le Corre, 2009, pp. 209; Le Gall & Ruellan, 2008, pp. 167), not being required for the commercial company to find itself in a desperate or irremediably compromised situation (Guyon, 1999, pp. 141).

The legal definition of cessation of payments – subject to criticisms either for the ambiguity of the used notions (Martineau-Bourgniaud, 2002) or for its rigidity (Guyon 1999, pp.135) - occurs after the jurisprudence succeeded in determining an exact content to this notion, the great advantage of this regulation is considered to be the clear demarcation of the notion of cessation of payments of the insolvency

[1] Regulated in France under the Law on January 25th 1985.

[2] The Ordinance no. 2008-1345 / December 18th 2008 on the reform of law for the companies in difficulty and the Decree no. 2009-160/ February 12th 2009 for applying the reform ordinance.

notion (Jeantin & Le Cannu, 1999, pp. 383), the cessation of payments being separate from the insolvency notion (Houin, 2007, pp. 250).

By the amendment of the French laws of insolvency achieved by the Law no. 2005-845 on July 26th 2005 – there have been eliminated the situations in which the debtor's cessation of payments did not represent a condition for opening the collective procedure.

Thus, by January the 1st 2006, the collective procedure for legal redress and dissolution could have been done without the compliance of the condition for the cessation of payments, under the following three situations:

(i) against the one that did not comply with a financial obligation undertaken on the occasion of an amiable settlement concluded with its lenders;

(ii) against the trader carrying out a business operated under lease ("location gerante" (for details, see: Hue, 2001, pp. 689) during a legal redress procedure and does not comply with the obligations acquired by the conditions established through the assignment plan authorized by the judge there shall be opened a legal redress procedure without the cessation of payments to be ascertained;

(iii) when the debtor fails to execute its financial obligations undertaken by the continuation plan, the tribunal orders the plan's resolution and opens a new economic redress procedure without the cessation of payments to be required (Ripert et al. 2000, pp. 855).

The elimination of these causes for opening the reorganization and legal winding-up procedure has been requested by the specialized literature which considers that, these exceptional situations should be abated, the payments termination becoming the only cause necessary for the opening of the collective procedure, as the legal redress of the debtor is a remedy, not a sanction (Guyon, 1999, pp. 144).

In Germany, the German Insolvency Code (Insolvenzodnung (InsO) adopted in October 1994 and effective as of January 1st 1999, defines the insolvency notion, but introduces a new concept for the continental law system of "imminent payment inability" as cause for opening the insolvency procedure.

Thus, it is established that the opening of the insolvency procedure is subordinated to the existence of the cause for opening (art. 16 InsO), the insolvency represents the general cause for procedure opening (art. 17 para.1 InsO) the debtor being in insolvency if it fails paying the debts, the insolvency being presumed when the

debtor ceases the payments (art. 17 para.2 InsO). In fact, it is about the debtor's incapacity to cope with the debts due lacking the necessary liquidities.

As a general rule, a commercial company shall be considered unable to pay its duties if it fails to pay 80% - 90% of its debts in 2- 3 weeks after becoming due.

As for the imminent payment inability, as a special cause for procedure opening, the German law leaves with the debtor to assess its imminent inability to pay (subjective criterion), being able to request the opening of the procedure when the debtor believes it cannot pay its existing debts upon maturity date (art.18 InsO).

The German law also establishes another special cause for opening the procedure, applicable exclusively to the legal entities: the excess of debts / over-indebtedness (surendettement) existing when the patrimonial assets of the debtor fail to cover the existing debts.

Therefore, in Germany there are causes for opening the insolvency procedure:

(i) payment inability;

(ii) imminent payment inability;

(iii) excessive debt.

In Italy, the article 5 of the Royal Decree no. 267 of 16th of March 1942[1] defines the insolvency as a state manifested as the failure to comply with the obligations or other external actions, demonstrating that the debtor is not able to pay regularly its obligations, state that can initiate the bankruptcy procedure opening.

In the light of these legal provisions, the insolvency state is identified with the inability to comply with the due obligations upon the maturity date, by using the normal means, the situation of the debtor's patrimony being irrelevant even if the assets are bigger than the liabilities (Ianniello, 2006, pp. 11).

By this definition of insolvency the "external actions" showing the state of insolvency are indicated; however, the insolvency can manifest also by internal actions, known by the entrepreneur alone, being in the presence of a "asymptomatic" (Meloncelli, 2002, pp. 107-111) insolvency that will form the grounds for opening the procedure by the debtor.

[1] The Royal Decree no. 267 / 16th of March 1942 - published in the G.U. no. 81 / 6th of April 1942, Supplemento Ordinario – has been successively amended through the Law Decree no.35 /14th of March 2005 transformed in the Law no. 80/May 14th, 2005, by the Law Decree no. 5/January 9th 2006 and by the Legislative Decree no.169 / September 12th 2007.

Spain, by the Law no. 22/2003 – the so called concurrence law - adopted in July 2003 and entered into force on September 1st 2004, replaces the old law regarding the bankruptcy procedure and also establishes the notion of imminent insolvency, as cause for opening the collective procedure upon the debtor's request.

Until the adoption of the Law no. 22/2003, the Spanish law made the distinction between the bankruptcy (quibera) and payment suspension (suspension de pagos) however, presently, the state of insolvency alone is defined (concurso).

Thus, according to the Spanish law vision the debtor is insolvent when he/it cannot pay regularly its due and payable debts (art.2 para. 2 Law 22/9th of July 2003 Concursal).

The debtor's insolvency is presumed to be in favour of the lenders when:

(i) the attempt to recover an asset based on an enforcement title has failed;

(ii) the current payments have been suspended, and there is a seizure affecting the debtor's assets;

(iii) in case of fraudulent bankruptcy or accelerated liquidation of the debtor's assets;

(iv) there is a generalized failure to comply with the certain debts, such as: taxes, social insurances, or salaries.

It is obvious that, there is no uniformity in the determination criteria for the business failure, for the bankruptcy of trade companies, the option for insolvability or insolvency being structural for most of the member states of the European Union, however, the approach is a flexible one, proving a tendency for accepting both criteria under the same national system (extracts, Tuleasca, 2009; Tuleasca, 2011).

3. The Balance Sheet Test or the Insolvability Criterion

3.1. The distinction, in our country, between insolvency and debtor insolvability has been made uniform, therefore, both, doctrine and case-law found this as the only cause of the bankruptcy: insolvency or cessation of payments with the categorical exclusion of the debtor insolvability.

Thus, in the common law, the insolvability is that state of the patrimony of a person characterized by a negative imbalance between his/her assets and liabilities,

i.e. obligations higher than rights. In case of insolvability, the entirety of debtor assets is not sufficient to pay all the creditors (Guyon, 1999, pp. 133).

Insolvency distinguish from debtor insolvability: while the insolvency is that debtor state which express his incapacity to pay the debts at the maturity from missing liquidities, insolvability is a state of financial imbalance of debtor patrimony, where the value of liabilities is bigger than the assets. The judicial reorganization procedure and bankruptcy, occurs in all cases where the debtor is in insolvency, without taking in consideration the ratio between the liabilities and assets of debtor's patrimony (Cărpenaru, 2004, pp. 586; Appeal Court of Bucharest, commercial court, Decision no. 131/1999).

Regarding bankruptcy, is take it in consideration the cessation of payments, and not the solvency or the insolvency, meaning the ration of liabilities and debtors assets, because there can be cases where it can be declared bankruptcy even if assets surpass the liabilities.

The interruption of payments is nothing else than the payments of some due debts. Whether the liability is bigger or less than assets, the trader insolvability does not implicitly entail the effective cessation of payments.

Insolvability must not be mistaken with commercial insolvency (...). While the insolvability means liabilities over assets (L>A), commercial insolvency puts the trader in the situation of being no longer able to pay his debts with liquidity (cash), regardless of the ratio between assets and liabilities (Piperea, 1996, pp. 57).

Under Law 85/2006 of insolvency[1], in Romania, in the matter of regular trade companies, solely the insolvency state can be the cause for applying the insolvency procedure and, implicitly the bankruptcy procedure.

The debtor's creditors are not interested in how the liabilities and the assets composing the debtor's patrimony are, but only whether the payments of the debts are made or not made upon the maturity.

The simplified procedure (bankruptcy procedure itself) is applied also for the insolvability cases, not only for the debtors' insolvency, situation regulated by art. 1, paragraph, letter c, pt. 1 of Law 85/2006 (Cărpenaru & Nemeş & Hotca, 2008,

[1] Law no. 85 on 05.04.2006 regarding the insolvency procedure, published in the Of. M., Part I no. 359 / 21.04.2006, as further amended and completed.

pp. 20-34), *respectively to the traders, legal entities, that do not own any goods in their patrimony/heritage*.

We believe that, in this case, the debtor insolvability will become subsequent to debtor insolvency, this being a criterion for choosing the procedure form of application. (extracts: Tuleasca, 2010; Tuleasca, 2011).

3.2. In the case of special trade companies, the insolvability has a special meaning, different from the one under the common law, such meaning being imposed by the functioning principles and by the activities of such entities.

3.2.1. Thus, *the bank's solvency has the role of covering the main banking risks: the credit risk*[1], *the operational risk*[2] *and the market risk*[3] *and of the capital requirements related to the fixed general expenses.* Usually, when determining the banks solvency, it is also considered the covering of other capital requirements and of transitory capital requirements.

In a much wider meaning, „*the bank's solvency represents: the banks' capacity to honour their covenants being, like the health of each individual, a complex given fact. The solvency is determined by numerous factors: the business management quality, an adequate internal organizational structure, the risks quality and last, it represents the financial aspect of the banks in the sense of financial capacity of sensing the kicks, meaning the capacity of absorbing the losses, capacity determined by their profitability and by the level of their own resources."* (Duplat, 1990, pp. 9; Leguevaques, 2002, pp. 71)

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[1] *The loan risk is the present or future risk of negatively affecting the profits and the capital due to the debtor's failure to comply with its contractual liabilities or due its failure to comply with the established liabilities* - art.2 para.5, let. j) of the National Bank of Romania Regulation no. 18/2009 regarding the frame of management of the credit institutions activities, the internal assessment process for capital adequacy to the risks and outsourcing conditions of its activities (Of. M. no. 630, 2009).

[2] *The operational risk is the loss risk determined by either the use of some inadequate processes, and systems and human resources or that such inadequately complied with their function, or by external events and actions. The operational risk includes also the legal* risk - art.2 par.1 let.c) of the National Bank of Romania Regulation no. 24 /2006 on determining the minimum capital requirements for the operational risk of the credit institutions and of the investment companies (Off. j. no.1035bis, 2006).

[3] *The market risk is the current or future risk negatively affecting the profits and capital caused by the market fluctuations of the prices of equity securities and of the interest rate regarding the activities included in the transaction portfolio, as well as by the foreign exchange fluctuations and those of the merchandise prices for the entire activity of the credit institutions* - art.2 para.5, let. m) of the National Bank of Romania Regulation no. 18/2009, *op.cit*.

In all cases, *„the bank's liabilities represent the bank's resources and a bank shall not be bankrupted because of its significant liabilities but because of its non-competitive assets or exaggerated assets"* (Bonneau, 1997, pp. 4).

Technically speaking, the bank's solvency is related to its own resources by reference to the capital requirements needed for covering the significant banking risks.

Therefore, *there is no connection between the solvency of a usual trade company and the solvency of a bank.* According to the substantive law of the trade companies regulated by the Romanian law, they are „solvable" if the assets are equal to the liabilities. In case of a negative patrimonial imbalance between the assets and liabilities, the liabilities are higher than the assets, the trade company is insolvable, therefore, is in a state of insolvency.

The basic principle of accountancy, the assets must be equal to the liabilities, is also applicable to the banks' accountancy, however, the significance of patrimonial assets and liabilities is different from the classical meaning.

In the banking area, an asset ("credit assets") represents a resource controlled by a credit institution as a result of past events, expected to generate future economic benefits for the credit institution, the cost of which being assessed in a credible manner.

A debt („credit liabilities") is a current obligation of the credit institution resulting from past events, the settlement of which would result in resources incorporating economic benefits. Under these conditions, *all the banking assets registered in the balance sheet or off-balance sheet are exposed to risks and represent the bank's exposure.*

The banks can solely survive provided that a minimum level of solvency is maintained, thus as this level is statistically determined; therefore the requirements on the bank's solvency represent the most important prudential measure imposed to such entities. The level of covering the banking risks by means of its equities that is the level of bank's solvency is determined by the solvency ratio.

The solvency ratio is the proportion between the equities and all the major banking risks /exposures, registered in the balance sheet or off-balance sheet, affected by risk weights, depending on their characteristics.

The minimum level of the solvency ratio of the banks is 8% being established under pct.3.2.a of the Annex 1- Adjusting the capital to risks of the National Bank of Romania Order no.13 of 2011[1].

The decrease of the solvency ratio under 8% immediately alerts the supervisory and control authority that will order the adoption of measures for financial recovery of the bank.

The banking experts consider that the banks can operate with a solvency ratio over 5% (Basel Committee on Banking Supervision, 2004) and, in certain cases, even with a ratio of minimum 4% however, bellow this last solvency level the bank faces a critical state of insolvency.

Obviously, with a solvency ratio bellow 2% the bank can no longer survive, the bank's risks /exposures are so high by reference to their equities that, probabilistically, the collapse is inevitable.

On the other hand, although the bank's insolvency represents a distinct form of the banking insolvency, it has a direct relation with the main form of banking insolvency: liquidity crisis or stoppage of payments (extracts, Tuleasca 2011).

3.2.2. Exactly like in the case of the banks, the insurance undertakings insolvability has a special meaning, different from the one under the common law.

The insurer's financial stability, a priority of both the insurer and the supervisory board, is mainly provided by the appropriate coverage of the risks undertaken and guaranteed and of those afferent to its investment activity. Thus, the insurer is bound to cumulatively the paid share capital and the minimal solvency margin.

In fact, the insurer is bound to hold, at any moment, the available solvency margin[2] *at least at the level of the minimal solvency margin calculated for each operated class of insurances.*

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[1] National Bank of Romania Order no.13 of on reporting the capital requirements for the credit institutions, published in the Of. M., Part I no. 786 of 04.11.2011.

[2] *The overall assets items free of any liens, except for the non-tangible assets correspond to the available solvency margin* – art. 2 paragraph 2 in The Romanian Insurance Supervisory Commission (CSA) Norms on the calculation methodology of the solvency margin available to the insurer operating general insurances, of the minimal solvency margin and of the security fund, implemented by the CSA Order no. 3/April 24th, 2008, published in the Official Journal, Part I no. 346/06.05.2008 and art. 2 paragraph 2 in the CSA Norms on the calculation methodology of the solvency margin available to the insurer operating life insurances, of the minimal solvency margin and of the security fund, implemented by the CSA Order no. 4/April 24th, 2008, published in the Official Journal, Part I

The available insolvency margin representing the positive difference between the assets and the liabilities – certain and the ones that may materialize in the future (net assets) (Constantinescu 2004, pp.361), the insurer's capacity to cover its losses without resorting to the equity should exceed or at least be equal to the minimal solvency margin. Thus, as said, the available solvency margin represents the main indicator of the insurer's financial health, its capacity to cover the unexpected losses so that its decrease below the minimal value set out by the prudential norms (below the value of the minimal solvency margin) indicates financial problems of the company, under the form of solvency crisis.

Under these circumstances, the decrease of the solvency margin below half the minimal limit set out by the legal regulations for the security fund indicates a profound solvency crisis, an irremediably compromised financial situation requiring the initiation of the bankruptcy procedure.

This form of the insurer's insolvency may be accompanied or not by a liquidity crisis and may be independent from the actual ratio of the insurer's assets and liabilities. The possibility that the future debts, unpredicted loss may not be covered is maximal and, for this reason, the solvency crisis represents the cause of the insurer's failure (extract Tuleasca, 2010).

4. The Liquidities Test or the Insolvency Criterion

4.1. In Romania, the Law no.85/2006 on the insolvency procedure[1], preserves both the condition for opening the collective procedure: the insolvency, defined as: *"that state of the debtor's patrimony characterized by the insufficiency of funds available for the payment of the certain, liquid, due and payable debts" (art.3 pct.1 of the Law no. 85/2006). The minimum quantum of the debt is RON 45,000, and for employees, of 6 national average gross wages /per employee.*

The novelty of the current regulation is defining the legal state of imminent insolvency and the cause for opening the collective procedure. The insolvency is imminent when *it is proved that the debtor shall not be able to pay upon due date*

no. 346/06.05.2008, as both CSA Norms have been amended by the CSA Order no. 12/July 24th, 2009 published in the Official Journal, Part I no. 543/August 5th, 2009.

[1] Law no. 85/05.04.2006, on the insolvency procedure, published in the Off. M., Part I no. 359/21.04.2006, as further amended and completed.

the due and payable debts he undertook, from the available funds available on the maturity date (art.3 pct.1, let. b of the Law no. 85/2006).

The existence of the insolvency state requires a more complex analysis than the simple definition of the insolvency or imminent insolvency notions, two defining elements under mutual interdependence resulting from it: the insufficient funds and the failure to pay the due debts.

The defining elements of the insolvency also include a sum of other aspects whole legal regulation and doctrinarian and jurisprudential clarification can altogether accurately establish the sphere of the insolvency notion.

The pecuniary funds insufficiency as a state of the patrimony, represents in fact, the debtor's inability to pay the certain, liquid and due debts out of the available funds. "The payment inability" has been considered "an objective *de facto* situation, the result of the comparison between the total amount of due debts and the available amounts of the debtor: the credit balance of the bank account plus the cash from the desk.

The opinions related to this view are quite different; they considered either that the insolvency state is more resembling to the situation of temporary financial difficulty of the debtor (Guyon, 1999, pp. 141) or the ascertaining of the interruption of payments – therefore the payment inability – as an irremediable situation.

Certainly, the inability to pay the debts does not consider the absolute inability to make payments, does not consider a situation with no way out, such an interpretation rendering, beyond its lack of accuracy, a very difficult burden of proof, the delay in opening the bankruptcy procedure and the elimination of any business redress opportunity (Jeantin & Le Cannu, 1999, pp. 385; Turcu, 1996, pp. 29).

What is characteristic for insolvency – under the aspect of complying with this condition – is the absence of the available funds sufficient for paying the due debts but also the impossibility to obtain a small support from the bank for paying the debts. In these terms, the debtor can be subjected to the collective procedure even if it has funds or liquidities, but such funds or liquidities are insufficient for the payment of the due debts. (The distinction between the term of "insufficiency" used under the law and the term of missing funds and the conclusion that the insolvency procedure can be open even if the debtor has certain funds and makes

certain payments, however such funds are insufficient for paying all the due debts (Piperea, 2008, pp. 282).

In our specialty literature the opinion is that the pecuniary funds a debtor possesses consider the credit balance from the bank account – from all the bank accounts it has, and not only from one or from the official one (Ploiesti Court of Appeal, Civil Section, Decision no. 372AA of April 24th 1998) plus the cash in the desk, by excluding the debts (Bucharest Court of Appeal, Commercial Section, Decision no.131/1999).

The Romanian specialized literature, influenced by the French and antebellum doctrine and case law, considers that the insolvency procedure must be applied also to the debtor that carries out with the payments by using fraudulent or ruining means of procuring liquidities. (Costin & Miff, 2000, pp. 66)

We consider that the expansion of the realm of the insolvency notion - in the current stage of the legislation, doctrine and case-law in our country – by the analysis of the funds origin and the inclusion of the cases of procuring funds by fraudulent means or by any other means contrary to an honest commercial practice in the state of liquidities insufficiency, cannot be possible[1].

The use of ruining means for procuring funds, for delaying the payment cessation of the legal entity, is relevant only from the aspect of the limitative cases that can entail the patrimonial liability of the member of the supervisory or management authorities, under the terms of the art.138 of the Law no. 85/2006 and under the aspect of the legal documents concluded by the debtor that can be cancelled under the collective procedure according to the art.80 of the Law no. 85/2006.

The failure to pay one or several certain debts upon maturity does not always have the meaning of an insolvency state, as the debtor can deny the payment of a debt, in good or bad faith, however possessing the funds and, hence, being solvable.

The insolvency is a state of the debtor's patrimony that must not be confused with insolvability or with the denial in making payments, as the payment of a debt represents also an act of will of the debtor.[2]

[1] In France, the doctrine and the case-law have constantly expanded the notion of cessation of payments thus as to include these cases.

[2] Cluj, Court of Appeal, Commercial Section, Decision no. 55R/April 9th, 2001; Decision no. 37R/March 11th 2000.

Therefore, the failure to pay a debt upon maturity must be the result of the debtor's inability to pay the debt from available funds (Turcu, 2000, pp. 26), the result of the missing or insufficient funds.

4.2. According to the banking regulation, according to the traditional conception on insolvency, *the two constitutive elements of insolvency as provided under the general regulation of the bankruptcy in Romania are also provided by this special cause of banks failure: the due liabilities and the imbalance between the available assets and available liabilities* (Leguevaques, 2002, p.323).

The defining elements of the banking insolvency under the form of liquidity crisis are: *the payment incapacity of the debtor or the insufficient funds and the failure to pay the due debts.* (In the specialized literature, the debtor failure to make payments is similar to available cash funds insufficiency. To this end, please see: (Cărpenaru, 2011, p. 735).

Thus, there is an imbalance between the assets and liabilities patrimonial value, but it is of a different nature: *„the liabilities are short and the assets are long"* (Le Nabasque, 1999, pp. 15).

In case of a bank, the lack of available funds required for the payment of the due debts represents a far more serious problem than in the case of any other trade company considering that, at any time, the bank can liquidate a part of its assets, that it can obtain loans from other partner banks or from the National Bank of Romania.

The correct management of the liquidity risk imposes that the actual available cash funds of the bank to be higher than the necessary available cash funds, the banks being required to maintain the liquidity ratio to a minimum limit of 1[1], calculated as the proportion between the actual available cash funds and the necessary available cash funds, per each maturity band.

The insolvency of the bank shall not be entailed by the occurrence of the liquidity risk, by the decrease of the liquidity ratio bellow 1 or independent of the occurrence of other banking risks.

This is the result of the fact that the bank has the possibility to overcome the „temporary financial embarrassment" or the „cash incident" (Nussembaum, 1996,

[1] Article 7 paragraph 1 of the National Bank of Romania Regulation no. 25 /08.11 2011 on the available funds of the credit institutions, Of. M. 2011, no. 820, Part I.

p.79) by injecting liquidities from inter-banking loans, from assets sale, from monetary market operations carried out by National Bank of Romania: sale of eligible assets (state securities, deposit certificates issued by National Bank of Romania, a.s.o.), collateral loan, foreign exchange swap, overnight loans, a.s.o. thus, the liquidity risk cannot generate per se the liquidity crisis able to lead to the bank's insolvency.

Usually, the bank shall not be able to rebalance the liquidity ratio and fails, when the occurrence of the liquidity risk has been concurrently caused by other banking risks, such as, the occurrence of the solvency risk and thus, the effects of liquidity risk occurrence cannot be overcome[1] (extract, Tuleasca, 2011).

4.3. In the matter of insurers insolvency, as resulting from the art.3 let. j pct.1 of the Law no. 503/2004, the defining elements of the insurance undertaking insolvency are, in its case, too, *the failure to pay the due debts and the obvious payment inability.*

The insurer's activity is subject to the liquidity risk[2] and, for this reason, the prudential norms determine the coverage modes of this risk by regulations on the insurer's financial investments and by the establishment of the liquidity coefficient as a criterion of the determination of the insurer's capacity to cover the liquidity risk. The liquidity coefficient represents the ratio of the insurer's liquid assets[3] and short-term liabilities towards the insured and indicates the liquidity risk coverage degree.

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[1] If the bank has significant solvency issues, such an aspect shall be soon known by the public and the bank shall be no longer able to obtain any loans, facing a liquidity crisis the bank will be unable to overcome.

[2] The liquidity risk represents the possibility of recording losses or of non-obtaining of estimated profits resulted from the insurers' impossibility to capitalize assets to honor at any moment and with reasonable the short-term payment obligations or from the difficult collection of the receivables in the insurance /reinsurance contracts - art.1 item 8 in the CSA Norm as of September 29th 2009, published in the Official Journal, Part I no. 621/September 16th, 2009.

[3] The following are considered liquid funds: government bonds and bonds issued by the public administration authorities, bank deposits, cash in bank accounts and cashier's office, transferable securities traded on regulated and supervised markets, equity securities in collective investment bodies in transferable securities.

In this respect, the insurer is bound to have the liquidity coefficient for the general insurance activity and for the life insurances of at least 1 (one)[1] situation in which the value of the liquid assets is equal to the quantum of the short-term liabilities.

Under these circumstances, the same as in the case of the regular trading companies, *the available funds consider first the cash, the operational cash-flow provided by the funds generated by the subscription operations and the incomes obtained from investments (*Constantinescu, 2004, pp. 371). But, a liquidity coefficient below the one determined by the prudential norms indicates the liquidity crises or the imminence of the insurer's liquidity crisis.

The failure of the insurance undertaking occurs when it undergoes an obvious inability to make payments, to obtain sufficient funds for the payment of the due debts, i.e. when it cannot overcome the liquidity crisis (extracts: Tuleasca, 2010).

5. Conclusions

The liquidities test and the balance sheet test, or the insolvency and insolvability, are the essential criteria for determining the business failure, usually materialized in the bankruptcy.

In the matter of general corporate law, the insolvency and insolvability have a similar meaning in the EU member states and all over the world, the liquidities test being used the most, in accordance with the Legislative guide on the insolvency law drafted by the United Nations Commission for International Business Law.

The legislator's option for one or another of these criteria represents a structural option depending on the legal culture of each state however, considering the economic causes and effects of the insolvability and insolvency, that tends to remove the unilateral, exclusivist options. The business failure of special companies: banks and insurance undertakings, is determined by the alternative use of both criteria: insolvency and insolvability.

On the other hand, if the meaning of insolvency *stricto sensu*, is similar in the matter of general corporate law and in the special corporate law, when it comes to insolvability, its substance fundamentally differs in the law applicable to the

[1] Art. 8 paragraph 6 in the Norm implemented by the CSA Order no. 9/2011 published in the Official Journal, Part I no. 325/May 11th, 2008.

regular traders and in the law applicable to the legal entities acting in the financial services sector.

To this end, the meaning of insolvability of the special trade companies - banks and insurance undertakings - as an essential criterion for determining its failure, has nothing to do with the traditional meaning of insolvability: the patrimonial liabilities are higher than the patrimonial assets. According to the special opinion, the insolvability does not indicate liabilities exceeding the assets of the banks and of the insurance undertakings but the fact that they do not have the capacity to cover their risks, i.e. the possible losses that could be generated by the occurrence of the main risks of their activity, and obviously, are not manifested externally. Regardless of the criterion established by law for determining the business failure, both the insolvability and the insolvency reflect the business failure or its inevitable occurrence.

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