



Bankruptcy and second chance for honest bankrupt entrepreneurs

Final report

Client: EC - DG Enterprise & Industry

Rotterdam, 31th of October 2014



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Rotterdam, 31th of October 2014

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Table of contents

Preface	5
Executive summary	7
Methodologies applied	7
Literature review	8
Data collection	9
Data analysis	11
Conclusions and recommendations	11
1 Introduction	13
1.1 EU policy background to the study	13
1.2 Objectives of this study	14
1.3 Methodology	14
1.4 Structure of the report	17
2 Background to the topic	19
2.1 Recent developments	19
2.2 Description of the bankruptcy process	20
2.2.1 Prevention of bankruptcy - Overview	21
2.2.2 Out-of-court settlements	22
2.2.3 Hybrid procedures	23
2.2.4 Formal in-court insolvency/bankruptcy procedures	24
2.2.5 Second chance	24
2.2.6 Effect of credit databases and credit scoring bureaus	25
2.3 Policies / regulatory framework	26
2.3.1 EU policies on bankruptcy and second chance	26
2.3.2 EU regulation of Credit databases and Credit Scoring Bureaus	27
2.3.3 Bankruptcy legislation in the EU Member States	28
2.3.4 National rules on Second chance	30
2.3.5 Support from international institutions	30
2.4 Comparison to the situation in the United States	30
2.4.1 Background	30
2.4.2 Mechanisms and policies in the US	31
3 Prevention of bankruptcy	33
3.1 Introduction	33
3.2 Available support measures to prevent bankruptcy	35
3.2.1 Prevention measures undertaken in different countries	35
3.2.2 Institutions taking care of prevention	37
3.2.3 Costs of prevention and reorganization	38
3.2.4 Survival rates of companies that have gone through prevention measures	40
3.3 Policy recommendations for more successful prevention of bankruptcy	41
4 Severity of bankruptcy procedures	43
4.1 Introduction	43
4.2 The efficiency of the bankruptcy systems	43

4.3	Policy recommendations for more honest entrepreneurs-friendly bankruptcy procedures	48
5	Ease of second chance after bankruptcy	50
5.1	Introduction	50
5.2	Ease of the second chance	52
5.3	Available measures facilitating a second chance	57
5.3.1	Second chance measures existing in different countries	57
5.3.2	Institutions taking care of second chance	60
5.3.3	Costs of second chance measures	60
5.3.4	Number of companies that have gone through second chance measures	61
5.4	Policy recommendations for a smoother second start	61
6	Role of Private Credit Scoring Bureaus	63
6.1	Introduction	63
6.1.1	Difference between credit rating and credit scoring	64
6.2	Key players and the environment	66
6.2.1	Private Credit Scoring Bureaus (PCSBs)	66
6.2.2	Credit Databases (CDs)	72
6.3	Analysis and key findings	76
6.4	Policy recommendations	83
7	Comparative mechanism	87
7.1	Introduction to the comparative mechanism	87
7.2	Selection of indicators	87
7.3	Outputs of the comparative mechanism	89
7.4	Link to the interactive version of the comparative mechanism	93
	Annex I: Sources	95
	Annex II: List of support measures	99
	Annex III: List of Private Credit Scoring Bureaus	109
	Annex IV: Selection of World Bank Composite Index	115
	Annex V: Interview reports	117
	A.V.1 Specific Questionnaire for Credit Scoring Bureaus	117
	A.V.2 Interviews	119
	Annex VI: Summarised country reports	125

Preface

On the 18th of December 2013, the Ecorys led Consortium was awarded the contract for a study on “Bankruptcy and second chance for honest bankrupt entrepreneurs” under Framework Contract No 146/PP/ENT/2012.

This final report provides (i) an update on the state of play of the implementation of the May 2011 Competitiveness Council Conclusions, (ii) an analysis on the specific stages of the bankruptcy processes of “prevention/reorganisation” and “treatment of the entrepreneur post-bankruptcy and conditions for a second chance”, and (iii) an overview of the role of private credit scoring companies in Europe with regard to bankruptcy and second chance.

The study team consisted of Paul Wymenga (team leader), Jakub Gloser (consultant), Edita Bezegova (consultant), Corine Besseling (consultant) and local experts from 33 countries across Europe. The study team was supported by Prof. John A.E. Pottow and Mr. Alexander Claus.

We appreciate the valuable advice from our resource persons Prof. John A.E. Pottow, Professor of Law at University of Michigan Law School, specialist in international commercial law, bankruptcy and consumer finance and Mr. Alexander Claus, Insolvency Practitioner at Tanger Advocaten in the Netherlands, as well as the guidance from Mr Marko Curavić (DG ENTR), Ms Lucyna Kaminska (DG ENTR), Ms Mihaela Carpus Carcea (DG JUST) and Ms Soledad Bernabe Casado (DG MARKT).

The Ecorys team
July 2014

The views expressed in this report are those of the consultant, and do not represent any official view of the European Commission. The responsibility for the content of this report lies with Ecorys Netherlands B.V.

Executive summary

Businesses create prosperity, jobs and growth in the European Union. The interest of the European Commission in bankruptcy and second chance policy is to prevent businesses from bankruptcy and in the case this is unavoidable to give honest failed entrepreneurs quickly a second chance in business. Therefore the Commission has since 2000 focused on policies that support the rescuing of viable firms that face financial difficulties and the creation of a second chance.

European rules on cross-border insolvency were enforced in May 2002. The Communication Overcoming the stigma of business failure – for a second chance policy, COM(2007) 584 final, asked Member States to give honest failed entrepreneurs a second chance and showed ways of how to overcome the stigma of business failure. The request for a second chance was reiterated by the 2008 Small Business Act for Europe in its Principle II. In a follow-up, the European Commission (EC) convened an expert working group on Bankruptcy and Second Chance that took stock of the situation in Europe and showcased the good practices in various countries¹. As a result, the Competitiveness Council of May 2011 invited the Member States to have in the case of failed enterprises/entrepreneurs a debt settlement and discharge time of maximally three years.

The increasing numbers of bankruptcies during the financial crisis (about 200,000 companies p.a.) resulted in further action by the EC: Communication COM(2012) 742, A new European approach to business failure and insolvency, which restates that honest failed entrepreneurs ought to have a second chance after bankruptcy and asks for a modernisation of the insolvency laws in the Member States, particularly with respect to a three-year discharge and debt settlement period.

A public consultation on business failure and insolvency was organised by the Commission in 2013 based on which a set of common principles for national insolvency procedures for business in financial difficulties was published in March 2014².

The specific aims of this study are to look at:

1. the extent to which Member States comply with the May 2011 Competitiveness Council recommendations on promoting a second chance and limiting the discharge time and debt settlement for honest entrepreneurs after bankruptcy to a maximum of three years by 2013³;
2. an analysis of the procedures for prevention/reorganisation as well as for the treatment of the entrepreneur post-bankruptcy and conditions for a second chance in European countries;
3. the provision of an outline of the work of private credit scoring companies in European countries, including an overview of the actors involved and their role in bankruptcy and second chance procedures.

Methodologies applied

The study made use of the following methodologies: (i) literature review to obtain the latest developments on the topic at hand; (ii) data collection in the EU-28 Member States, Iceland, Norway, Turkey, Serbia and Montenegro; (iii) data analysis in order to compare countries among each other; (iv) interviews; and (v) a specific survey for Credit Scoring Bureaus.

¹ http://ec.europa.eu/enterprise/policies/sme/business-environment/files/second_chance_final_report_en.pdf

² C(2014) 1500 final, Commission recommendation of 11.3.2014 on a new approach to business failure and insolvency

³ The maximum discharge time of three years is also mentioned in COM(2012) 742

During the study the contractor has also consulted two Resource Persons who are active in the topic of this study.

Literature review

The bankruptcy process

The bankruptcy process can be split up into different stages, including: prevention measures, reorganisation procedures, out-of-court procedures, formal in-court procedures, bankruptcy settlement and second chance. The focus of our study is on bankruptcy of *entrepreneurs*, but where we discuss financially distressed *companies* in particular, the term insolvency is used according to common practice.

Prevention of bankruptcy concerns the early recognition of financial problems, so that these problems can be solved in time before more expensive "survival" measures need to be taken. Restructuring can be very costly for SMEs as legal advisers and insolvency practitioners can charge high fees. Bankruptcy and insolvency procedures differ significantly per Member State.

Second chance means formerly bankrupt or failed entrepreneurs re-starting their entrepreneurial activities. There is evidence that these entrepreneurs can use their experience and lessons learnt to let their new businesses grow faster in terms of turnover and jobs. There is also evidence that in countries favouring the possibility of second chance there are higher levels of entrepreneurship⁴.

Both the prevention stage as well as giving a second chance can be influenced by credit scoring bureaus. These bureaus have analytical models that can function as early warning systems. Once an entrepreneur is aiming to restart his/her activities that entrepreneur needs, or will get a new credit score. Thus the credit scoring bureaus play a key role for saving entrepreneurs in difficulties as well as entrepreneurs returning into business.

EU policies and regulatory framework

As noted in the above, the EU framework in the area of cross-border insolvency stems from the year 2000. Given that bankruptcy legislation is a national competence, changes in the bankruptcy laws of Member States depend on actions of national governments. The Small Business Act for Europe (2008) in Principal II invited Member States to ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance. Furthermore, in December 2012, the EC adopted a Recommendation to Member States on "a new approach to business failure and insolvency", with the objective to give viable enterprises facing financial problems access to national insolvency frameworks that enable them to restructure or to reorganise at an early stage to prevent insolvency and to give honest entrepreneurs comparable conditions for a second chance after bankruptcy regardless of their location in the European Union.

Harmonisation of bankruptcy laws would reduce the currently emerging development of regulatory arbitrage ("bankruptcy tourism"), which is a phenomenon where debtors relocate their centre of interest to another Member State with a more favourable insolvency law compared to the home country (Regulation of the Council nr. 1346/2000 and its revision) and file there for bankruptcy. The rules for second chance also differ greatly by Member States, in particular the discharge procedures, including the lengths of the discharge period.

⁴ Burchell and Hughes (2006)

Comparison: Bankruptcy procedures in the US

Frequently, the US are mentioned in the literature as an example of a legal system that allows for a second chance: in the US, bankruptcy is regulated at Federal level. However exemptions are regulated at State level. Most States recognise the exemption related to the private property of individuals that cannot be considered during bankruptcy and are exempted from liquidation (though a second house is not). A car, a computer or machinery are also exempt in most States if it can be proven that they are necessary for maintaining an income or to look for a new job or business opportunity.

The US has a system of pre-bankruptcy procedures for companies called “Chapter 11” (“Chapter 13” for individuals). Under this Chapter the law provides temporary protection from creditors and allows time for restructuring. This means that a deal is struck with the creditors on the method of repayment and in return no liquidation of assets takes place. The alternative is to file under “Chapter 7”, which means closing the business. The European way of preventing bankruptcy is further discussed in detail in Chapter 3.

Credit rating and scoring

Credit rating agencies (CRAs), are required to register with the European Securities and Markets Authority (ESMA) and the public ratings they issue, must be issued in accordance with Regulation (EC) No 1060/2009 on credit rating agencies. In general, credit ratings are assigned to debt issues, equity issues and structured products. In May 2014, there were 23 CRAs registered and two certified CRAs in the EU. The three biggest players in the sector (Moody's, S&P and Fitch) account for approximately 90% of the market in the EU.

As opposed to credit rating agencies there is no direct EU regulation or oversight for Private Credit Scoring Bureaus. In terms of Credit Databases, the legislation and reporting standards are the responsibility of each Member State.

There is a significant difference between CRAs and Private Credit Scoring Bureaus (PCSBs). The latter organisations are private non-financial companies that mainly provide a client with an analysis of the creditworthiness of a company, entrepreneur or a sector as opposed to CRAs that mainly rate individual corporations', issues and products. PCSBs are not fully regulated and supervised at EU level.

There is evidence that the introduction of small business Credit Scoring has improved the access to finance for SMEs (Berger, Frame, Miller (2002)). Hence this study has focused on PCSBs and Credit Databases (CDs). The latter concerns specialised companies and/or public bodies that collect financial information available on a company/entrepreneur, format it and present it in the form of Credit Databases.

Data collection

Information was collected on the entrepreneur-friendliness of the bankruptcy procedures as defined by law in the 33 European countries with respect to:

- Court neutrality: In 31 countries courts are seen neutral; in Italy and Norway there is no court neutrality implying the court favours either debtors or creditors.
- Length of time of debt plan repayment: Only in 11 out of 33 countries the average time of debt plan repayment is less than 3 years; in Estonia there is no time limit for debt plan repayment.
- Repayment plan is part of the bankruptcy court procedure: This is the case in all countries, except for Belgium, Cyprus, France, Norway and Poland.
- Judicial and administrative roles are separated: This exists in about two thirds of the countries.
- The possibility of creditor's committees meaning there can be coordination among creditors: In five out of 33 countries, creditors' committees do not exist.

- Tax legislation increasing the recovery rate (cents on the euro) of creditors: This exists in 12 out of 33 countries.
- Average time of bankruptcy procedures: The average length of bankruptcy procedures is about 26 months, with outliers for Cyprus, Czech Republic, Turkey and Italy where the procedures can take more than five years.
- Exemptions of certain assets from bankruptcy proceedings: These exist in 19 out of 33 countries.
- Non-financial consequences of a bankruptcy: These exist in 15 out of 33 countries with the consequence that bankrupt entrepreneurs with a valid excuse obtain the unfair stigma of being fraudulent.

Country-specific information was also collected on available support measures that aim to avoid bankruptcy by (i) prevention measures as well as (ii) survival procedures. The first group of measures focuses more on the identification of financial problems in a very early stage. These measures are less common in the European countries than the survival procedures, notably the out-of-court pre-bankruptcy settlements, which exist in 19 out of 33 countries.

The level of costs of prevention can be problematic as companies in financial distress do not have many resources available. In general, the number of companies that have benefitted from prevention measures is difficult to come by.

Also on the ease of second chance data was collected in the 33 countries for the following indicators:

- Difference in treatment of honest / fraudulent entrepreneurs: Only one third of the 33 countries treat the two groups differently.
- Special procedures for SMEs: Only 7 out of 33 countries offer a specific fast-track or less expensive bankruptcy procedure for SMEs.
- Possibility to get full discharge: This possibility exists in all countries except for Serbia.
- Period of time to obtain discharge: The average time to obtain discharge after liquidation is 28 months.
- Automatic discharge: This is in place in half of the European countries.
- Period of time of negative scoring: On average it takes about 40 months until a negative score is removed after discharge.
- Deleting from a credit database after discharge: In most countries, where a credit database exists, an entrepreneur remains in the credit database for some years to maximally 100 years in two countries.

Overall it can be said that prevention measures have been identified more frequently in the European countries than second chance measures. Thus, more needs to be done on Second Chance support.

This study identified and investigated 138 PCSBs and 51 CDs operating in all European countries; 15% of the identified PCSBs also have CDs. In three countries CDs do not exist⁵.

⁵ Italy, the Netherlands and Romania

A credit score is constantly updated as the company is monitored. Upon termination of the insolvency procedure and the passing of discharge time, the credit scoring is in theory deleted. However, in practice the study found that this is only applicable for a company but not for an individual entrepreneur, who will carry the negative score for some time after the end of a bankruptcy (between 0-10 years). This is the case in most countries, whereas in Spain and in Luxembourg the score is never deleted.

Data analysis

Both quantitative and qualitative information collected by the country experts has been structured to enable the analysis.

Composite indices have been constructed for each country by scoring the indicators on the entrepreneur-friendliness of the bankruptcy procedures as well as on the ease of second chance.

- The countries with the highest scores on entrepreneur-friendly bankruptcy systems are Austria, Latvia and Slovakia.
- The countries with the highest composite indexes for ease of second chance are Romania, Portugal, Slovenia and Croatia.

From the qualitative information it was among other things concluded that the earlier action is taken to prevent a bankruptcy, the lower the costs involved. Early warning systems and awareness raising as well as financial skills of the entrepreneurs are very important for this. When it comes to support measures to facilitate a smooth second chance after bankruptcy, the availability is limited in many countries.

On the question how long a negative scoring remains with an entrepreneur, the study found that the time for an entrepreneur to be deleted from a CD takes longer than the time that a negative score remains with a bankrupt entrepreneur, which applies in twelve countries. This negatively impacts the chance for a successful restart after bankruptcy.

The PCSBs are very well placed to be used as early warning systems, since they already perform this activity for their clients and have the means to do so efficiently.

Conclusions and recommendations

On prevention of bankruptcy:

- Entrepreneurs are to be encouraged to take action at a very early stage of financial problems. The right environment needs to be created to make this happen;
- Training on financial planning and management to small entrepreneurs would also improve the situation of early stage financial problems;
- Establishing automatic early warning systems could be worthwhile to study further for example by using information from delayed tax payments;
- Preventive tax support measures can be considered to help companies overcome temporary financial issues;
- The creation of an efficient system of exemptions will enhance the second chance for restarting honest entrepreneurs, such as temporary tax breaks;
- Entrepreneurship education at secondary school is advocated to reset the mind set that a bankrupt entrepreneur is a "loser";
- A uniform/harmonised bankruptcy legislation, which can contribute across the EU to an equal treatment of honest entrepreneurs as well as the recognition of out-of-court and hybrid procedures can avoid regulatory arbitrage/"bankruptcy tourism".

On a smoother second chance:

- Entrepreneurs should know what the ways forward are after a bankruptcy and after discharge; and also know how a bankruptcy procedure looks like, what are the steps and the "content" of each step;
- Eliminate the measures that prevent second starters from accessing start-up finance;
- Ensure that honest entrepreneurs get rid of negative credit scorings almost immediately after discharge;
- Convince the countries where there is no distinction between honest and fraudulent behaviour of entrepreneurs to change their bankruptcy legislation and introduce a different treatment;
- Make the discharge process as fast as possible to save the resources of the failed entrepreneur for a possible restart.

On Private Credit Scoring Bureaus and Credit Databases:

Minimal standards and quality oversight (somewhere along the lines of the ECAI system) is advocated for the PCSBs to increase their legitimacy.

It is also recommended:

- to monitor or/and to limit the length of time that negative information is kept on honest bankrupt entrepreneurs by the PCSBs and CDs;
- to have CDs available in all countries in the EU to increase the use of such databases;
- to have access to financial information from PCSBs and CDs across the EU;
- to reconsider the exemption of micro enterprises for publishing their annual accounts or to let micro enterprises provide financial information with less administrative burden (by for example using new ICT techniques and software).

1 Introduction

1.1 EU policy background to the study

European rules on cross-border insolvency were drawn up in the Regulation (EC) No 1346/2000 to coordinate insolvency proceedings opened in several Member States. In 2002 an Expert Group recommended⁶: i) the introduction of early warning schemes to enable earlier detection of financial difficulties; ii) legal systems with specialised insolvency sections of Courts; iii) a fresh start for non-fraudulent debtors and iv) information and education programmes against stigma on business failure.

The 2007 Communication on “Overcoming the stigma of business failure”⁷ mentions that business failure is inherent to our dynamic societies and therefore relevant authorities should devote sufficient financial means to fresh starts by removing barriers to public finance schemes for re-starters.

The Small Business Act of 2008⁸ mentioned in Principle II: “The Member States should ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance”.

The final report of the Expert Group of 2011⁹ recommends among other things that Member States should prioritise their interventions to support SMEs in the following order:

1. Prevention;
2. Post bankruptcy and second chance;
3. Out-of-court settlements;
4. In-court procedures.

By the end of 2012 a Communication on the new European approach to business failure and insolvency¹⁰ advocated: Modernising the EU’s insolvency rules to facilitate the survival of business and presenting a second chance for entrepreneurs.....as a key action to improve the functioning of the internal market”.

A public consultation was held by the Commission from July-October 2013 to obtain views on the European approach to business failure and insolvency proposed by the 2012 Communication. Following the public consultation the European Commission released in March 2014 a set of common principles for national insolvency procedures to facilitate the restructuring of businesses including:

- *Facilitate the restructuring of businesses in financial difficulties at an early stage;*
- *Allow debtors to restructure their business without needing to formally open court proceedings;*
- *Give businesses in financial difficulties the possibility to request a temporary stay to adopt a restructuring plan before creditors can launch enforcement proceedings.*

⁶ Final Report of the Expert Group (2003), Best Project on Restructuring, Bankruptcy, and a Fresh Start

⁷ COM(2007) 584 final

⁸ http://ec.europa.eu/enterprise/policies/sme/small-business-act/index_en.htm

⁹ http://ec.europa.eu/enterprise/policies/sme/business-environment/files/second_chance_final_report_en.pdf

¹⁰ COM(2012) 742 final

1.2 Objectives of this study

The financial and economic crisis has caused a dramatic rise in the number of insolvent companies in Europe. Most of the entrepreneurs that went out of business as a result of the crisis were *bona fide*¹¹. However, notwithstanding the efforts and invitations of the EC in the last 12 years, there is still a lack of efficient legal and policy measures to rescue viable businesses or wind up those that cannot be saved.

Moreover, it is wrong to stigmatise honest failed entrepreneurs, which for long has been the custom in Europe. The EU Small Business Act of 2008 (Principle II) wants to give honest bankrupt entrepreneurs a second chance, especially because these entrepreneurs are more experienced and thereby tend to grow faster and employ more workers.

In this context, the Competitiveness Council of May 2011 invited the EU Member States to have a debt settlement and discharge time of maximum three years. Furthermore, the 2012 Communication¹² stated that the aim of modernising the insolvency laws in the Member States is to give honest entrepreneurs a second chance after bankruptcy. This was the response of the Commission to the fact that during the last crisis about 200,000 European companies went bankrupt every year.

Thus this study comes at the right time. It has the following objectives:

- to provide an update on introduction by Member States of the 3-year deadline of the European Council on the discharge time and debt settlement for honest entrepreneurs; and
- to give policy makers a measuring mechanism in order to obtain insights on how to (a) reduce discharge times and (b) improve the simplicity of procedures.
- to provide further proposals for legislative and policy actions to foster bankruptcy prevention and a fair second chance for honest bankrupt entrepreneurs.

More specifically this study has looked into:

- the extent to which Member States comply with the May 2011 Competitiveness Council recommendations on promoting a second chance and limiting the discharge time and debt settlement for honest entrepreneurs after bankruptcy to a maximum of three years by 2013;
- an analysis of the prevention (stage 1) and the treatment of the entrepreneur post-bankruptcy and conditions for a second chance (last stage) in European countries¹³;
- the provision of an outline of private credit scoring companies/bureaus in European countries, including an overview of the actors and their role in bankruptcy and second chance procedures.

1.3 Methodology

This study is not based on one single methodology, but combines several methods to get the complete overview of the topic and the related issues. These methodologies are listed below.

Literature review

In an earlier stage of the study, we have conducted a literature review to create a sound knowledge basis of the latest developments in the fields of the project for the study team. Prof. John A.E. Pottow and Mr. Alexander Claus, our two resource persons, have been instrumental in guiding the team towards the most relevant sources.

¹¹ COM(2007) 584 final states on p. 4 "only 4-6% of bankruptcies are fraudulent."

¹² COM(2012) 742

¹³ The stages mentioned belong to the consecutive sub-areas that compose the bankruptcy process, see Chapter 2 for further details about this.

Country data collection

Country-specific information on bankruptcy, second chance, and credit scoring has been collected by a team of country experts. The following 33 countries are covered in this study: the EU-28 Member States, Iceland, Norway, Turkey, Serbia and Montenegro.

To gather all the relevant information, the country experts have interviewed the following types of persons or organisations:

- Member State experts on bankruptcy and second chance¹⁴;
- Regulators / government bodies (in many cases the Ministry of Justice);
- Courts / out of court resolution bodies;
- Credit rating agencies or credit scoring bureaus;
- Business stakeholders (e.g. entrepreneurs with experience in getting bankrupt or getting a second chance);
- Curators or insolvency practitioners;
- Institutions dealing with “prevention”;
- Institutions dealing with “second chance”.

The country experts have gathered the information in the first half of 2014, and hence the information presented in this report reflects the situation in the countries as of that period.

In the Inception Phase of the study, three pilot country studies have been carried out (Croatia, Ireland and Spain) to test the questionnaire, instruction document and output document. In the interim phase, the remaining 30 country studies have been carried out by our country experts. They used the questionnaire and the instructions that were improved based on our experience with and lessons learned from the pilot country studies.

All the data were checked and verified by the core project team in order to get good quality and comparable information for all countries.

Data analysis

The country experts have collected quantitative and qualitative information. The quantitative data on several indicators have been used to calculate scores and composite indices to compare countries with each other. The qualitative information has been put into a comparative analysis matrix to facilitate the qualitative comparative analysis.

Interviews

Some in-depth interviews have been carried out with credit scoring bureaus. These have given us valuable insights into the functioning of the credit scoring system as well the main issues that credit scoring bureaus face. They have also been valuable in pointing towards possible recommendations as well as bringing additional information for the ensuing analysis.

Survey of Credit Scoring Bureaus

Throughout our contacts with the Federation of Business Information Services (FEBIS) we have launched an additional short, but specific questionnaire focused on their members. This has provided us with additional country specific information on credit scoring bureaus as well as on credit databases.

¹⁴ The list can be found here: http://ec.europa.eu/enterprise/policies/sme/business-environment/files/bankruptcy_second_chance_expert_en.pdf.

Comparative mechanism for key characteristics of bankruptcy regulations

Insolvency laws, the availability and quality of support measures on prevention, second chance and arrangements on credit scoring differ widely across the 33 countries. Next to that, the chances of companies in financial distress are affected by many other factors. Therefore, we did and could not establish an *absolute measure* of which countries are doing best and which countries are doing worst in terms of preventing bankruptcy and facilitating a second chance. *Comparing* countries with each other and pointing out key characteristics however gives very valuable insights, which can be used to understand the specific situation in each country and allows policy makers and stakeholders to learn from each other.

Policy recommendations

Based on all the above steps and findings from this study we have formulated policy recommendations for both prevention of bankruptcy, post-bankruptcy/second chance, and credit scoring bureaus. They can be found in the last sections of each chapter.

1.4 Structure of the report

Chapter 2 presents the background to the topic. Chapter 3 looks in depth at the prevention of bankruptcy in the 33 countries, while Chapter 4 looks into the bankruptcy process itself and its severity. Chapter 5 focusses on the life of entrepreneurs restarting post-bankruptcy. Chapter 6 deals with the role of private credit scoring bureaus in the context of prevention of bankruptcy and second chance, and Chapter 6 presents the comparison mechanism. The relevant information collected and the study material used by the project team can be found in the annexes.

2 Background to the topic

2.1 Recent developments

Prevention of bankruptcy and a second chance for honest bankrupt entrepreneurs are the first and the last stage of the bankruptcy process which entrepreneurs in financial distress have to pass. Before we delve deeper into that process and the specific stages, we look at some figures to give an idea about the size of the issue in Europe, which has been significant in the past years.

Table 2.1 below shows the number of corporate insolvencies in the recent crisis period for a number of European countries and the US. The data show the number of official insolvency applications that were accepted by local courts. According to Creditreform (2013), the number of corporate insolvencies in Western Europe has increased in 2012 by 2.6 percent compared to 2011. For Central and Eastern Europe this figure is 13.6 percent.

Table 2.1 Numbers of corporate insolvencies in some European countries and the US, 2008-2012

	2008	2009	2010	2011	2012
<i>Western Europe</i>					
Austria	6,500	7,076	6,657	6,194	6,266
Belgium	8,476	9,382	9,570	10,224	10,587
Denmark	3,709	5,710	6,461	5,468	5,456
Finland	2,612	3,275	2,864	2,944	2,956
France	49,723	53,547	51,060	49,506	48,340
Germany	29,580	32,930	32,060	30,120	28,720
Greece	359	355	355	445	415
Ireland	773	1,406	1,525	1,638	1,684
Italy	6,498	8,354	10,089	10,844	12,311
Luxembourg	590	698	918	961	1,033
Netherlands	4,635	8,040	7,211	6,176	7,373
Norway	3,637	5,013	4,435	4,355	3,814
Portugal	3,267	4,450	5,144	6,077	8,605
Spain	2,528	4,984	4,845	5,910	7,799
Sweden	6,298	7,892	7,546	7,229	7,737
Switzerland	4,222	5,215	6,255	6,661	6,841
UK	16,268	19,908	17,468	18,467	17,748
Total Western Europe	149,675	178,235	174,463	173,219	177,685

<i>Central and Eastern Europe</i>					
Bulgaria			700	685	1,285
Croatia			1,501	4,878	7,000
Czech Republic			5,559	5,880	7,723
Estonia			504	623	588
Hungary			17,487	30,757	36,274
Latvia			2,407	813	867
Lithuania			1,496	1,302	1,354
Poland			665	762	881
Romania			21,692	22,650	21,974
Slovakia			830	870	866
Slovenia			510	675	595
Total Eastern Europe	No data	No data	69,895	69,895	79,407
<i>United States of America</i>					
US	43,546	60,837	56,282	47,806	40,075

Source: Data from Creditreform Economic Research Unit (2013)

In this study we will look at how more bankruptcies can be avoided in the future by prevention measures, and how honest entrepreneurs – once bankrupt – can get a fair second chance to restart a business.

2.2 Description of the bankruptcy process

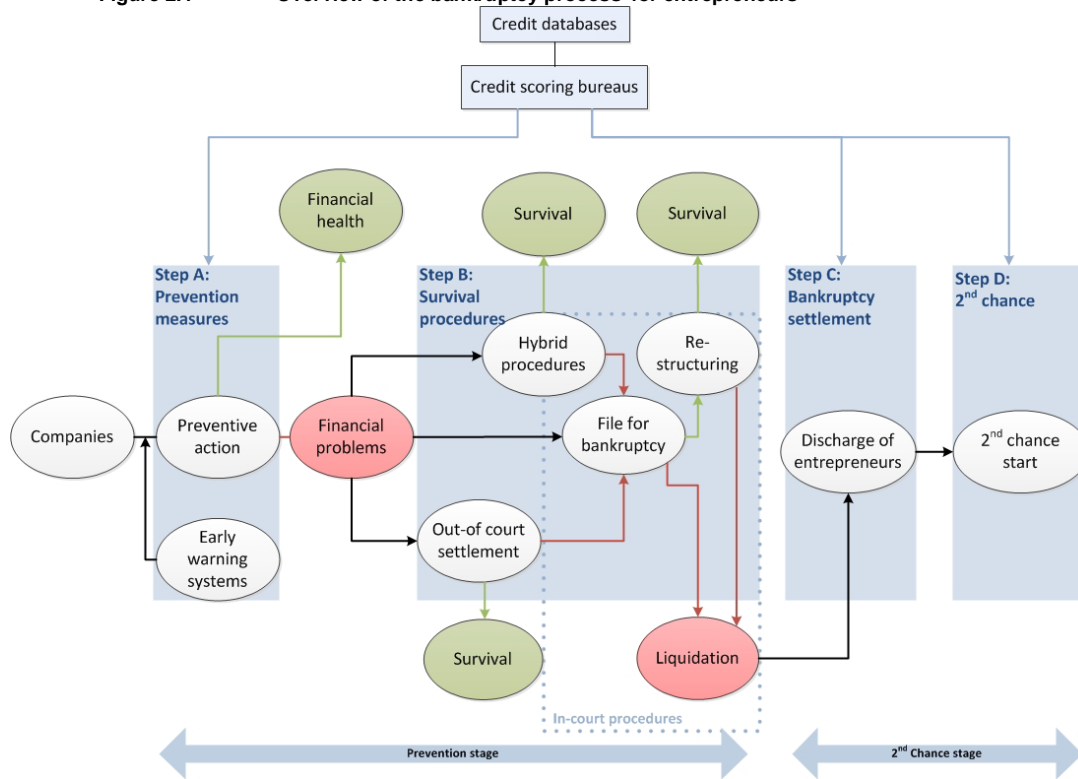
Bankruptcy can be defined as “the legal proceeding that occurs when the liabilities or debts of an enterprise exceed its assets or revenues over an extended period of time” (Calogirou et al, 2011¹⁵).¹⁶ Bankrupt entrepreneurs are seen as honest when the failure has not been the obvious fault of the entrepreneur: he/she has not been fraudulent or irresponsible (EC, 2012).

The bankruptcy process can be split up into different stages, including prevention, out-of-court settlements, hybrid procedures, formal in-court procedures, and second chance (EC, 2011 and IMF, 2013). Figure 2.1 provides an overview of the different stages through which an enterprise goes in case of financial distress. The next section describes these stages one by one.

¹⁵ When we refer to Calogirou et al. in this literature review, reference is made to the Calogirou, C., Fragozidis, K., Houdard-Duval, E., Perrin-Boulonne, H. (2010), **Business Dynamics: Start-ups, Business Transfers and Bankruptcy**, PLANET S.A., CCIP, DTI and GFA, Published in 2011 by the European Commission, DG Enterprise and Industry.

¹⁶ In some countries bankruptcy can also be brought about if the entrepreneur has negative personal capital.

Figure 2.1 Overview of the bankruptcy process for entrepreneurs



Source: Ecorys

As the focus of this study is on *entrepreneurs*, throughout this report in general the term “bankruptcy” is used when it concerns entrepreneurs. Following common practice, the term “insolvency” is used for financially distressed *companies* (incorporate enterprises).

2.2.1 Prevention of bankruptcy - Overview

The first stage of bankruptcy that an enterprise enters begins at the time when it starts to experience financial problems. In this stage, a bankruptcy can still be prevented and the earlier the detection and intervention, the higher the chance of surviving without any further problems. However, entrepreneurs are often not very willing to ask for external assistance at that early stage, for example because they fear that they will lose control of their business (EC, 2011).

A first step towards preventing bankruptcy is the use of early warning mechanisms, which are tools to predict whether a company will get into financial difficulties in the coming period. These tools do not solve the problems, but help businesses identify the problems. Concrete examples of early warning systems that exist in EU Member States are (Calogirou et al, 2011):

- internet self-tests (online questionnaires for entrepreneurs to identify their level of risk to fail);
- call centres providing answers to entrepreneurs that fear a failure;
- credit scores, financial analysis or stress tests.

A second step are preventive procedures, which a business in difficulty can use to avoid their insolvency:

- informational meetings that entrepreneurs can attend when they face difficulties;
- training courses that entrepreneurs can attend when they face difficulties to learn how to save their financially distressed companies;
- support services offered by public agencies to avoid bankruptcy of financially distressed enterprises.

- Protection from creditors, i.e. "buying time" allowing to restructure. For example, in the US "Chapter 11" gives protection from creditors and gives time to restructure the company and survive (see Box 3.2 for more information).

Preventing bankruptcy at an early stage is important as the total value to creditors, employees, owners and the entire economy could then be maximised (EC, 2014). Examples of (personal economic) losses for stakeholders in the enterprise in case of bankruptcy are (Burchell and Hughes, 2006):

- Investors lose value from investments (bonds or shares);
- Creditors (such as banks) have to write down loans;
- Clients lose money because they ordered and paid for goods that they did not yet receive;
- Suppliers of goods and services who already had sent their products but did not yet receive the money;
- Employees lose their jobs and due salaries;
- Tax authorities lose revenues if businesses fail;
- Negative externalities caused by rapacious behaviour (of major creditors) as they force liquidation on other creditors;
- Increased unemployment benefit payments from public and private funds because of loss of jobs.

Baxter (1967) finds that direct bankruptcy costs for small firms from the US are about 20% of their assets' value, far more than for large enterprises. By using data from New Zealand, Bradbury and Lloyd (1994) estimate that direct costs of insolvencies of large firms are 8% of firm value, while this percentage is 14.3% for small firms. These figures are not including indirect bankruptcy costs. Altman (1984) reports "indirect bankruptcy cost is equal to lost sales and profits resulting when potential buyers of a product or service perceive that default is likely." For US firms, Altman reports indirect bankruptcy costs can vary between 8% and 10.5% of firm value.

Three options exist to rescue a business in financial distress and make it survive: (1) out-of-court settlements, (2) hybrid procedures or (3) formal in-court procedures. The choice for a specific option – where national laws present such options – depends on several criteria, for example the number and heterogeneity of creditors (Garrido, 2012). When it is too late for effective prevention, the only solution should be quick liquidation, but this can also take the form of a sale as a going concern which is preferable to a piecemeal sale, since it minimises the liquidation losses for all stakeholders including the debtor.

It should be noted here that it only makes sense to rescue viable businesses. If an enterprise is not viable, it is better to liquidate it soon, because otherwise the prevention efforts are only delaying the inevitable outcome for the company and are thus a waste of time and money (Garrido, 2012).

2.2.2 *Out-of-court settlements*

When it is too late to solve the initial financial problems in an early stage, companies may have to restructure. However during such periods of financial problems, companies and in particular SMEs often cannot afford a long process of restructuring with the help of external advisors which bring along considerable costs. Next to the court, there are less expensive, simpler and often faster procedures for restructuring and settlement with creditors that take place out-of-court (EC, 2011).

In out-of-court procedures, affected creditors and the debtor are trying to come to a voluntary agreement for recovering the receivables (with or without guarantees from the debtor) in order to let the company survive as a going concern (Calogirou et al., 2011). This could take the form of

changing the company's repayment timetable, or even trimming the total size of the debt. For larger companies debt-equity swaps are also common.

There are two types of out-of-court settlement: a *contractual workout*, which is a contract between debtor and its creditors for the debt rescheduling, and *enhanced procedures*. In the latter, the contract is complemented by voluntary negotiation, mediation, or informal dispute resolution. This could be necessary for cases where there is a coordination or aggregation problem due to a large number of heterogeneous stakeholders (Garrido, 2012).

Next to the costs and the time, an advantage of out-of-court settlement is that the reputation damage that the entrepreneur might get is minimal as there is hardly any publicity involved (EC, 2011). However, there is also the risk that the debtor and creditors do not come to an agreement and an in-court procedure is needed anyway. This is because out-of-court procedures are voluntary and the creditors simply can refuse alterations to the terms and condition of the debt. Such problems particularly occur when there is a negotiation position imbalance, such as a large creditor or large supplier versus an SME debtor. A World Bank report (2011) mentions that for cases that have to go back to court after a failed out-of-court attempt, total costs and time of the settlement procedure may increase.

2.2.3 Hybrid procedures

The second option for companies in financial distress is a hybrid procedure, which is a combination of in-court and out-of-court elements. In these cases, the contractual arrangements between debtor and creditors are supported by the intervention of a court (Garrido, 2012). An example comes from France, where two preventive hybrid procedures can be used: the ad hoc mandate and the conciliation, which are both out-of-court settlement proceedings ("règlement amiable"). These procedures are carried out in a different way even though their goal is the same. The aim is to provide a confidential and out-of-court negotiation of the company's debts. An ad hoc agent or a mediator, appointed by the President of the Court, assists the debtor. In 60% of the cases, the proceedings have a successful outcome, and lead to the preservation of the company (Greffé du Tribunal de Commerce de Paris, 2014).

The IMF (2013) mentions that some European countries have introduced so called "fast track court approval procedures", in which the debtor and creditors negotiate the debt restructuring plan before starting the insolvency procedure. A typical element of hybrid procedure is a short term "standstill" period, in which creditors refrain from enforcing claims and in which the debtor gets time to focus on the restructuring plan. When there is agreement on the plan by the (majority of) creditors, it is sent to court where it will be reviewed. The significant advantage above out-of-court settlement is that there is a court-approved restructuring plan, and it is faster than a formal in-court procedure.

Another example of an effective hybrid measure comes from the Netherlands, where the courts appoint "secret curators" to rescue distressed companies. A company in financial distress can go to court and indicate that they would like to try to continue business without any publicity. The court then appoints a secret curator, with the task to quietly prepare a continuation of the company or a part of the company. This person does not get a formal position within the company, but supervises the process of sale of the company and prepares the asset transaction. After an agreement is reached (the so-called "pre-pack"), the official bankruptcy process is started and the secret curator becomes the official curator. The sale and continuation of the company can then take place quickly and without any problems (Jongepier and Hoogenboezem, 2013). The pre-pack can be considered as a concept assets agreement which has been prepared in advance of the bankruptcy on behalf of all the creditors. The buyer of the assets can pursue the activities of the failed company.

Examples have shown that also the creditors benefit from a so-called “pre-pack” by a secret curator. Some discussions are going on about the position of creditors in these situations. A few courts choose not to appoint secret curators because there is no legal basis. Now legislation is being proposed to take away these uncertainties. Banks are however already positive about the initiative because a secret curator has more time to find possible investors or buyers than under an in-court bankruptcy procedure when this has to be done under full publicity and high time pressure. The advantage of a secret curator is that clients do not walk away or suppliers refuse to deliver (Jongepier and Hoogenboezem, 2013).

2.2.4 Formal in-court insolvency/bankruptcy procedures

Formal court procedures are needed where the company is already insolvent, or if for any reason the out-of-court settlement or hybrid procedures have not lead to the adoption of a restructuring plan. A judicial bankruptcy process often follows a failed out-of-court settlement attempt. There are two potential outcomes of the court procedure: shutting the company down (liquidation) or restructuring (EC, 2011). A difference can be made between operational restructuring (restructuring of debtor’s business, also called reorganisation) and financial restructuring (restructuring of debtor’s finances) (Garrido, 2012). During a restructuring process, changes are made to the composition, conditions and/or structure of assets and liabilities of debtors, with the objective to continue the entrepreneur’s activities, whether in whole or in part (EC, 2014).

The success of restructuring in insolvency procedures depends on the rules regulating restructuring plans (content and procedures). These rules differ significantly by Member State. Restructuring can be very costly, in particular for SMEs, for example because insolvency practitioners and legal advisors could charge high fees. Therefore, liquidation is often the only solution for smaller companies (EC, 2012).

2.2.5 Second chance

Second chance means the re-start of entrepreneurial activities by formerly bankrupt or failed entrepreneurs (Calogirou et al, 2011). It is worthwhile to give honest bankrupt entrepreneurs a second chance as evidence shows that these entrepreneurs can use their experience and lessons learnt to let their new businesses grow faster in terms of jobs and turnover. Evidence shows that the attitude towards second chance across countries is positively correlated to GDP growth (Burchell and Hughes, 2006). This is probably not only caused by re-starters, but a fair second chance after failure also triggers would-be entrepreneurs to start a new business, as they become less afraid of failing and so entrepreneurial activity increases (EC, 2011).

The biggest fear of would-be entrepreneurs is indeed the possibility of going bankrupt (Calogirou et al, 2011) This is confirmed by results from the Eurobarometer 2012¹⁷, which finds that 43 percent of European citizens see the risk of going bankrupt as their main concern in case they started a new business. This is mainly because of the consequences that are linked directly to the individual as a result of a bankruptcy. These negative consequences can be categorised into three main groups¹⁸:

- *Reputation* – in most countries bankruptcy has a strong social stigma that is then attached directly to the individual.
- *Discharge time* – after bankruptcy there is a time in most countries in which the individual cannot start a new company.

¹⁷ http://ec.europa.eu/public_opinion/flash/fl_354_sum_en.pdf

¹⁸ According to one of our resource persons.

- *Penalties* – in some countries punitive penalties apply not only to fraudulent entrepreneurs but also to honest bankrupt entrepreneurs, such as bars on public office, access to public procurement, or even managerial positions.

Empirical evidence shows that more entrepreneur-friendly bankruptcy laws (in terms of the possibility of getting discharge) lead to higher levels of entrepreneurship through a higher number of would-be entrepreneurs. A more forgiving bankruptcy law offers partial insurance against the consequences of failure, and it lowers the risk tolerance threshold for risk-averse entrepreneurs (Armour and Cumming, 2008).

Empirical evidence from Japan shows that a change of the bankruptcy legal system in favour of second chance (by softening the consequences of failing), encourages entrepreneurial activity. Even more interestingly, it shows that decreasing the risk also attracts entrepreneurs with higher education, previous experience from the industry and overall of higher quality. These then go on to form higher performing firms (Eberhart et al., 2012). In other words, more favourable second chance legislation not only encourages *more*, but also *better* entrepreneurship.

2.2.6 Effect of credit databases and credit scoring bureaus

Figure 2.1 showed that both the prevention stage as well as the second chance are affected by credit scoring bureaus.

In fact credit scoring bureaus operate analytical models that are designed to function as early warning systems to investors, or clients. In this way credit scores can either effectively warn of upcoming issues giving time for preventive measures, or can publicise and highlight financial issues zapping away confidence and fast-tracking financial problems and not allowing preventive measures to take place.

Having said that, empirical studies have proved that having clear and in-depth information on companies and their financial health, such as that provided by credit scores, has helped companies in accessing finance. Furthermore having clear information means that the most efficient solution can be chosen, thus supporting market efficiencies and performance.

Secondly, once an entrepreneur is aiming to restart, he/she will need a new credit score that will ideally accurately represent the credit risk of his/her new entity. In this way if outdated information about a previous bankruptcy remains in credit databases and if it is part of a credit scoring model, the entrepreneur's conditions for a restart will accordingly be negatively affected. The deletion of outdated credit information is therefore key in this process that can ultimately greatly impact the success of second chance.

2.3 Policies / regulatory framework

2.3.1 EU policies on bankruptcy and second chance

One of the first EU actions on bankruptcy was taken in the year 2000 by adopting the Council Regulation No 1346/2000 on Cross-Border Insolvency Proceedings.¹⁹ About 25 percent of the bankruptcies in the EU have cross-border elements. Without proper recognition and coordination of national insolvency proceedings, there could be incentives for bankrupts to transfer assets or proceedings to the country where their legal position is most favourable (EC, 2012). The EU Regulation on Insolvency Proceedings from the year 2000 deals with this cross-border insolvency issues as well as issues of overlapping claims originating from different jurisdiction.²⁰

This abovementioned regulation from 2000 focussed on cross-border cases and did not harmonise the substantive insolvency laws that are used for normal domestic bankruptcy cases, which are under the legislative competence of Member States. This means that the creditors and debtors in the different Member States are still not treated equally. Harmonisation of the laws would lead to a better functioning Internal Market as currently disincentives still exist for companies that would like to establish themselves in another Member State (EC, 2012). In 2012 the Commission proposed to amend the scope of the 2000 regulation to include preventive procedures and personal bankruptcy proceedings (EC, 2012). This amendment does however not deal with differences in procedures in national bankruptcy laws as this is not an EU competence.

The Communication, COM(2007) 584 final, invited EU countries to overcome the stigma of business failure in the framework of the promotion of entrepreneurship under the Growth and Jobs Strategy.

The Small Business Act for Europe (2008) calls for the promotion of a second chance for honest entrepreneurs (principle 2). The May 2011 Competitiveness Council has also invited the EU Member States to promote a second chance for honest entrepreneurs and reduce the discharge time and debt settlement to a maximum of three years after bankruptcy by 2013 (EC, 2012).

Very recently, the European Commission adopted a Recommendation on “a new approach to business failure and insolvency”, with the objective to give viable enterprises that face financial problems access to national insolvency frameworks that enable them to restructure at an early stage to prevent insolvency, and to give honest entrepreneurs a second chance after bankruptcy, regardless of their location in the European Union (C (2014) 1500 final)²¹: Member States are invited to implement a new framework to harmonise insolvency procedures, so that entrepreneurship, investment and employment will be promoted²². Furthermore it will contribute to a smoother functioning of the EU single market by reducing the obstacles to cross border investment and difficulties in restructuring cross-border groups of businesses.

¹⁹ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32000R1346&from=EN>

²⁰ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2000:160:0001:0018:EN:PDF>

²¹ This will solve the problem that out-of-court and hybrid procedures are not the same in all countries so that creditors who don't like these procedures can enforce their claims against a debtor who is located in another country.

²² Prof. P.M. Veder, a legal expert argues in “Wetenschap, Afl. 5, September-October, p.88” that the Commission emphasises the employment that need to be rescued by a reorganisation of enterprises. In his view an enterprise should only be rescued when the going concern value surpasses the liquidation value and that the interest of the creditors come first.

2.3.2 EU regulation of Credit databases and Credit Scoring Bureaus

In terms of Credit Databases (CDs)²³, the legislation and reporting standards are the responsibility of each Member State. They therefore differ widely depending on national regulations, traditions and approaches (DG Internal Market, 2009). Nevertheless overarching data protection is given by the EU's Data Protection Directive (Directive 95/46/EC). On top, there often are obstacles and restrictions to cross-border sharing of credit data on individuals and companies for commercial purposes (DG Internal Market, 2009).

Box 2.1 Data Protection Directive

The Data Protection Directive focuses on the protection of individuals with regard to the processing of personal data and on the free movement of such data. This complex legislation defines the right to privacy for all EU citizens and states that personal data should never be processed at all unless three conditions are met:

Transparency – the data may be used when:

- the data subject has given his permission;
- the processing of such data is necessary to enter into a contract;
- processing is necessary to comply with legal obligations;
- processing is necessary to protect the interest of the data subject;
- in the public interest;
- when processing is necessary for the purposes of the legitimate interests pursued by the controller or by the third party or parties to whom the data are disclosed, except where such interests are overridden by the interests for fundamental rights and freedoms of the data subject. The data subject has the right to access all data processed about him. The data subject even has the right to demand the rectification, deletion or blocking of data that is incomplete, inaccurate or isn't being processed in compliance with the data protection rules. (art. 12).

The individual's data should only be used for **legitimate purpose**.

Personal data should be used **proportionally**. "Personal data may be processed only insofar as it is adequate, relevant and not excessive in relation to the purposes for which they are collected and/or further processed" (art. 6).

As far as direct regulation, or oversight of Private Credit Scoring Bureaus (PCSBs)²⁴ there is no overall EU legislation, nor common standards for credit scoring (as opposed to credit ratings). Prior to 2013, there was an EU wide accreditation (under Capital Requirements Directive III) of "External Credit Assessment Institutions" (ECAI) that included both credit rating agencies as well as PCSB. These were minimal standards that these institutions had to abide by and included a strict application process to prove the resilience of their models and company. Each ECAI would be accredited and monitored by the national authority. The ECAI accreditation gave credit scoring bureaus that had applied for ECAI status with their national competent authorities, greater legitimacy and allowed them to sell their products to financial institutions.

The CRR regulation, implemented in July 2013, harmonised the definitions to only include credit rating agencies, which are registered, authorised and supervised by ESMA in the EU. In addition, in accordance with the Basel III rules (that were also implemented in this Regulation) PCSBs could no longer be outsourced by banks as the sole risk assessment tools, insisting rather that financial institutions develop their own internal procedures, models and departments.

²³ For more information on CD please see Section 5.2.2.

²⁴ For detailed explanation of PCSBs please see Sections 5.1.1 and 5.2.1

2.3.3 Bankruptcy legislation in the EU Member States

The actual national bankruptcy and insolvency legislation is the competence and responsibility of the EU Member States. Bankruptcy legislation should on the one hand protect the interests of creditors. On the other hand, it should keep viable companies alive and create an environment in which entrepreneurs dare to take risks and start new companies (Succurro, 2012). According to the IMF (2013), key features that corporate insolvency law should ideally have are clear filing criteria, support of the rehabilitation of viable firms, speedy liquidation of non-viable firms, “stay-on enforcement actions” (standstill period), priority status to creditors who provided finance for successful restructuring, and cross-border insolvency.

Many differences exist across Member States in terms of criteria for opening insolvency proceedings, rules on mandatory filing of insolvency, the capacity of creditors to commence proceedings against debtors, rules on filing and verifying claims for creditors, and rules regarding restructuring plans. Because the differences are significant, foreign creditors are often in a worse position compared to domestic creditors, as the former often do not have sufficient knowledge of the procedures in other Member States. Therefore, it would be beneficial if differences between legislations would be reduced (EC, 2012). Furthermore, harmonisation of bankruptcy laws would reduce the currently emerging development of regulatory arbitrage or “bankruptcy tourism”, which is a phenomenon where debtors file for bankruptcy in a foreign country with a more favourable insolvency law compared to the home country (IMF, 2013).

Having said that, such arrangements can be perceived either as a “race to the bottom” or “race to the top”. Either that it allows for inefficiencies to persist and companies to bypass procedures, or that it simply allows healthy competition and the best system to be used more often. The debate remains unresolved in the academia and even the UN’s body (UNCITRAL) has been debating the matter for a long time with no concrete conclusion.

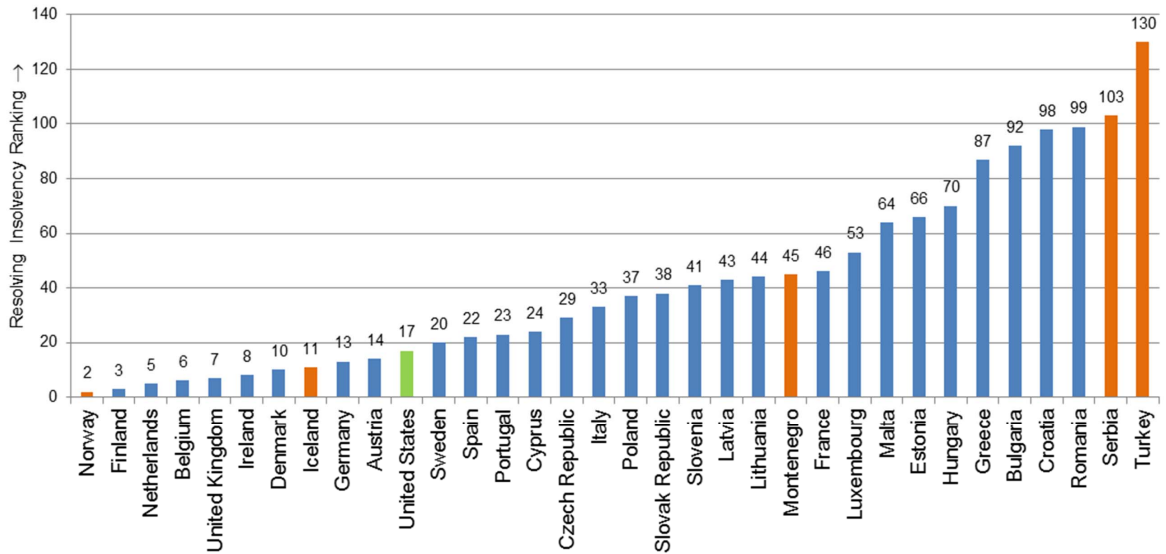
The IMF (2013) has also noticed the differences between European countries. According to this IMF report, the insolvency frameworks of some European countries, in particular in Eastern Europe, are weak and inefficient. In many of the reform countries, there is a perceived lack of well-trained and competent insolvency practitioners and judges, next to lengthy and costly procedures. The insolvency frameworks of the Nordic and Benelux countries on the other hand are characterised by short turnaround times, relatively low costs and high recovery rates.

The World Bank has ranked 189 countries for their efficiency of insolvency procedures. The indicator takes into account weaknesses in existing bankruptcy law and the main procedural and administrative bottlenecks in the bankruptcy process.²⁵ The more efficient a country’s bankruptcy procedures are compared to other countries, the higher the ranking.

Figure 2.2 shows the ranking of the EU28 Member States, the countries participating in the Competitiveness and Innovation Programme (CIP) that were selected for this study (Iceland, Norway, Turkey, Serbia and Montenegro) as well as the United States. The number above the bars indicates the rank of the country. Although not shown in this figure, the country that ranks first and hence has the most efficient insolvency procedures according to this measure, is Japan. Norway and Finland rank respectively second and third. The figure shows that there are ten European countries in which it is easier to resolve insolvency than in the United States.

²⁵ Source: <http://www.doingbusiness.org/data/exploretopics/resolving-insolvency>

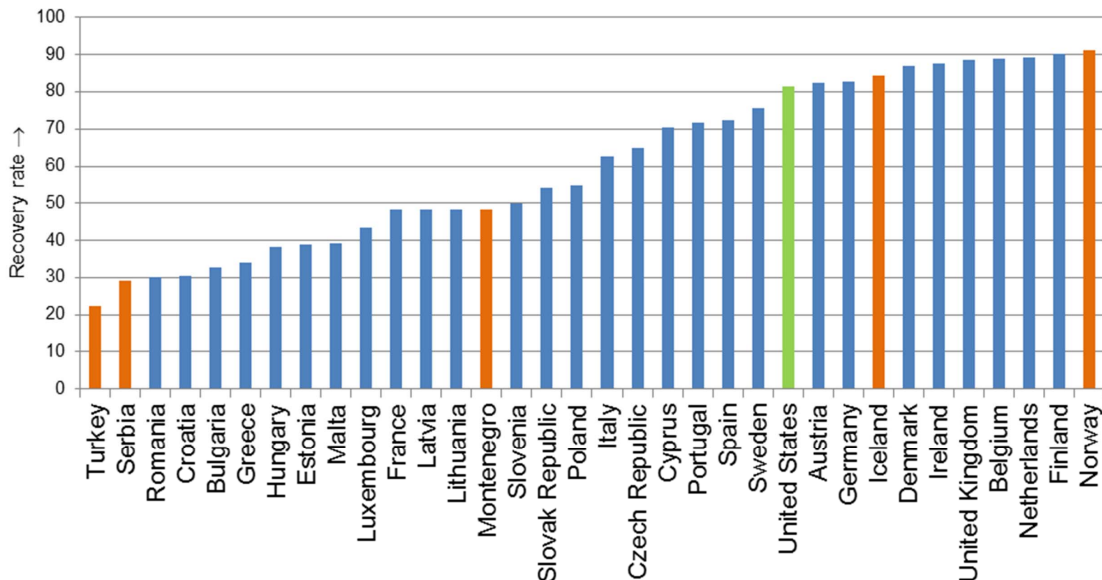
Figure 2.2 Ranking of the ease of resolving insolvency (EU28, selected CIP countries, US), 2013 data



Source: World Bank, Doing Business dataset, 2013

Figure 2.3 presents the differences in recovery rates for the countries selected for our study and the US. These rates indicate how many cents on the euro creditors recover from an insolvent firm.²⁶ So from this country selection, creditors in Norway are in the best position when a company enters insolvency. In EU member states such as Finland, the Netherlands, UK, Belgium, Denmark and Ireland the recovery rate is more than 85 cents on the euro. Eight EU countries are, from a creditor's point of view, in a better position than the United States.

Figure 2.3 Recovery rates (cents on the euro), 2013 data



Source: World Bank, Doing Business dataset, 2013

²⁶ The data does not distinguish between secured and unsecured debt.

Figure 2.2 and Figure 2.3 are not totally independent from each other, there is some correlation. Therefore, although in reverse order and with some exceptions, the selected countries are almost in the same order. This is logical as the more efficient the bankruptcy system is, the more money can be recovered for the creditors.

2.3.4 National rules on Second chance

Like insolvency rules, the national rules for a second chance also differ greatly by EU Member State. In particular, the discharge procedures vary, for example in terms of the conditions for granting discharge and the length of the discharge period (EC, 2014).

Many European countries have committed themselves to address second chance in their legislation in the future (EC, 2012). Following the Review of the SBA from 2011, Member States agreed that the period for discharge and debt settlement should not be longer than three years.

More specific differences between countries will appear from the 33 country studies, of which the results will be discussed in the next chapters.

2.3.5 Support from international institutions

Countries that want to improve their insolvency and debt settlement systems can get help from the Debt Resolution and Business Exit program of the World Bank. Countries can get advice on legislative and institutional reforms.²⁷

The Doing Business report of 2012 of the World Bank²⁸ notes that since the crisis of 2008/09, changes in the insolvency regimes have been made by 65 countries. Spain, Denmark, Italy, Latvia and Austria passed in the past few years laws to make it easier to restructure insolvent companies.. Good practices in insolvency regimes have been propagated by the World Bank by setting time limits on insolvency proceedings and providing a legal framework for out-of-court workouts.

2.4 Comparison to the situation in the United States

2.4.1 Background

People in the United States appear to have higher levels of failure tolerance (attitudes towards the risk of a business failing) compared to people from Europe. Also, there are relatively higher levels of entrepreneurial activity in the US (Burchell and Hughes, 2006).

Burchell and Hughes (2006) find that the US, despite relatively higher levels of failure tolerance, are not more open to give failed entrepreneurs a second chance. Legal reforms are therefore necessary for supporting a second chance.

In the US, bankruptcy is regulated at the federal level (as opposed to EU, where it is done at Member State level). A bankruptcy process in the US is defined if *collective action is issued*. This means in practice that if only one lender is in dispute with the borrower the case is referred to bilateral negotiation, rather than a bankruptcy process that aims to settle multiple claims equitably.

²⁷ <https://www.wbginvestmentclimate.org/advisory-services/regulatory-simplification/debt-resolution-and-business-exit/>

²⁸ Available at: <http://www.doingbusiness.org/reports/global-reports/-/media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB12-Chapters/Resolving-Insolvency.pdf>

The courts also have the right to dismiss a bankruptcy case on the grounds that it is not made in *good faith*. If for example a company or entrepreneur was trying to avoid paying his debts, or obligations by filing for bankruptcy, while in good financial health, this would not be considered in the spirit of the legal setting and not be accepted by a judge.

However, exemptions are regulated at the state level. Exemptions relate for example to the private property of individuals that cannot be considered during bankruptcy and are therefore exempted from possible liquidation. Such objects are mostly defined as necessities for living and acquisition of income. For example the primary residence is exempt from liquidation in most states, albeit to varying dollar amount differences, while second houses are not. A car, a computer or machinery are also exempt if it can be proven that they are necessary for maintaining an income or to look for a new job/business opportunity in many states. Evidence shows that the larger the exemptions in the law, the higher the levels of entrepreneurship (Armour and Cumming, 2008).

However, these exemptions do not apply if the entrepreneur pledges the assets voluntarily, by for example purposefully re-mortgaging his main house to raise capital for his business. In this way as the action is intentional from the side of the entrepreneur, the house would not be exempt and could also be repossessed during a litigation or bankruptcy procedure²⁹.

2.4.2 Mechanisms and policies in the US

The US has a system of pre-bankruptcy procedures for companies called "Chapter 11" (Chapter 13 for individuals). Under this chapter the law provides temporary protection from creditors and allows time for restructuring. This means that a deal is struck with the creditors on the method of repayment and in return no liquidation of assets takes place. This is a particularly useful mechanism to attempt to prevent bankruptcy and help a temporarily struggling enterprise (Baird and Morrison, 2005), although PCSBs in the US do not distinguish between Chapter 11, or 7 and simply label them both as "bankruptcies".

The alternative is to file under "Chapter 7", which essentially means closing the business. The court appoints a caretaker to liquidate assets and divide that between creditors. When it comes to small companies and entrepreneurs, their personal assets are often directly intertwined with their business assets. There are of course limits to the personal assets that can be liquidated as different laws on exemptions apply. However, once Chapter 7 bankruptcy has been completed, all future earnings are exempt from the obligation to repay. In other words, the failed entrepreneur gets a "fresh start"³⁰ (Fan and White, 2003).

Empirical evidence shows that indeed the availability of Chapter 7 and a very swift "fresh start" encourages entrepreneurs to go into business (Fan and White, 2003). On the other hand, despite the positive effect of Chapter 11, evidence shows that the prolongation of a firm's lifespan rather than immediate closure does often not prevent the eventual closure of the business some time later. It is sometimes not a preventive mechanism, but rather a system that temporarily supports struggling firms by essentially "rent controls" (putting a cap on firms' costs caused by its own obligations) (Baird and Morrison, 2005). When such mechanisms do not even achieve the aim of rescuing the firm (as the study suggests this happens too often), they cause market distortions and prevent a smooth functioning of a competitive environment (Baird and Morrison, 2005)³¹.

²⁹ It should be noted that further research needs to be conducted on the frequency that such practice actually occurs as well as if such voluntary pledges are of secured or unsecured debt.

³⁰ Individuals are permitted to file chapter 7 only once every 8 years. However, if the individual has to file chapter 7 due to his business activities, rather than personal ones (he cannot pay debt due to opening a pizza store, rather than buying a large TV) such restriction are lifted and he can file chapter 7 without restrictions. Thus entrepreneurs are given an unlimited "fresh start" as opposed to individuals, who have time restrictions.

³¹ Although the extent of this is currently being debated by different academics.

The bankruptcy reform of 2005, formally known as the "Bankruptcy Abuse Prevention and Consumer Protection Act" (BAPCPA), significantly altered the above mentioned system.

- Firstly it put restrictions upon who can participate in the beneficial Chapter 7. Individuals above the average state income would be obliged to first file under Chapter 13. However, if the individual was active in a business activity this did not apply. In this way the regulation tried to tackle personal abuses of the system, while keeping the option open for entrepreneurs that often have their personal finances intertwined with the business.
- Additionally the reform made bankruptcy procedures more costly and unfavourable for all individuals. As a consequence, the number of personal bankruptcies decreased dramatically after 2005, since then declaring bankruptcy was less favourable and therefore used under more serious pressure compared to before, where it was an easier and cheaper mechanism to default on debt. However, since such a move increased the risks of going into business, the entrepreneurial activity also decreased (Paik, 2005).
- For companies a similar (but lighter) procedure of limiting direct access to Chapter 7 was imposed on those with over \$2.5m annual turnover (Paik, 2005).
- For small companies of less than \$2m of debt the process of reorganisation (Chapter 11) was made harder. The company was only permitted to file under the chapter if it had a "viable" restructuring plan. The aim behind this was that small companies were occupying a lot of the capacity available for Chapter 11, while in most cases Chapter 7 would be the better option. This approach has been criticised by academics as not being based on data and that it will impose administrative burdens ("viable" restructuring plans are expensive as they involve lawyers, analysis and man power) to the companies most vulnerable, thus undermining their ability to survive.

In essence for SMEs and entrepreneurs this has meant that prevention is even more difficult to obtain and in most cases unless a viable plan for a turnaround is presented, the litigation option is always chosen. This legislation can therefore be seen as mainly focused on consumers in an attempt to change the consumer bankruptcy behaviour.

The US also has a Chapter 9, which is reserved for municipalities (such as the current process with the city of Detroit)³². This is essentially a version of Chapter 11, with the exception that the failure of the process cannot result in Chapter 7 (since these are not companies, nor individuals). However, 'claw back' and 'look back periods' also apply, which can also mean for instance the suspension of extraordinary state worker pension benefits by the city of Detroit.

³² This does not cover States as their arrangements must be made with either the federal government or the creditors without a legal system.

3 Prevention of bankruptcy

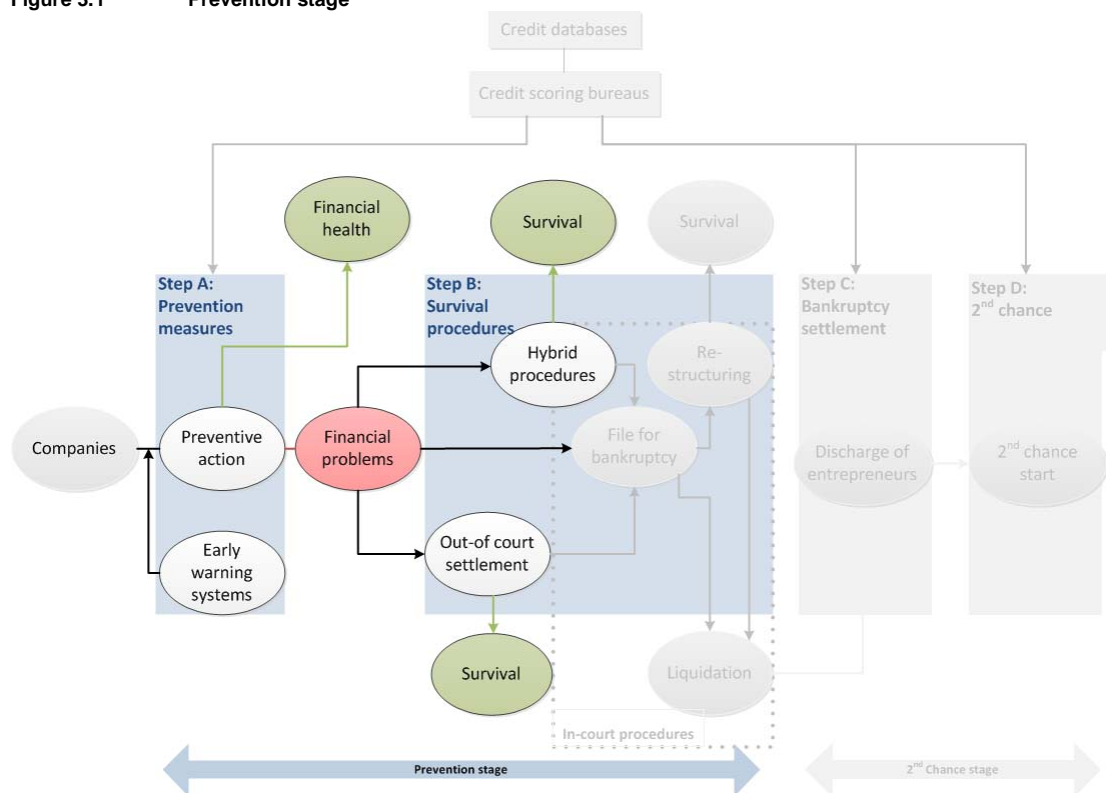
3.1 Introduction

The Expert Group report, published in January 2011 has identified “prevention of bankruptcy” as the first priority intervention area for policy makers in EU Member States to support SMEs. Therefore we will now zoom in on the prevention stage. Whereas we already described this stage in the previous chapter, we will now identify the particular aspects where policy makers could play a role in order to prevent bankruptcies of distressed but viable enterprises and thereby increase entrepreneurship. This is done based on literature review and country specific information gathered by the 33 country experts.

Figure 3.1 below again provides the overview of the bankruptcy process for entrepreneurs, and highlights the stage that we will look at in this chapter. The prevention stage can be divided into two steps:

- Step A.** Prevention measures, e.g. early warning systems or prevention campaigns to avoid, identify, and solve financial weaknesses in a very early stage;
- Step B.** Survival procedures, e.g. agreement with creditors or standardized settlement procedure in order to let the distressed but viable company survive.

Figure 3.1 Prevention stage



Source: Ecorys

Although the 2011 Expert Group sees out-of-court settlement as a separate stage next to prevention, we include it in this chapter as it clearly aims to solve financial problems and prevent

bankruptcy. Also INSOL Europe (2013) suggests that the “pre-insolvency” stage to rescue the business is broader than only solving the financial problems without involving the creditors. Pre-insolvency procedures include the procedures that can be taken before the insolvency test is carried out by court to determine whether the debtor is insolvent, and hence the start of formal court procedures.

Successful prevention of bankruptcy

The literature hints to some aspects that need to be addressed for successful prevention of bankruptcy. These aspects have been taken into account in the country studies.

The efficiency of bankruptcy procedures is not determined by the type or focus of the specific legal system that a country uses (common/civil/etc.), but significant efficiency gains can be obtained by implementing specific provisions like early warning systems, possibilities for out-of-court settlement, fast-track procedures for SMEs, hybrid procedures, etcetera (Calogirou et al, 2011).

Early warning systems and support services for companies in financial distress could exist, but entrepreneurs often do not act in time because they think that they will overcome the problems by themselves, are overoptimistic of the outcomes (cognitive bias of denial), they fear the consequences, or all of the above. The other eventuality is that they are simply not aware of the problem (unknown bias), or of the existence of preventive services (EC, 2011). The solutions should fit the issue at hand. Awareness raising is important for successful prevention, but also more proactive early warning mechanisms should be implemented (see Section 3.3). Furthermore, entrepreneurs should get the incentive to take action in an early stage. This could be done by rewarding early filing or sanctioning late filing (INSOL Europe, 2013), or by discrete help (see solutions in Section 3.3).

The costs related to restructuring often determine whether restructuring is possible or if liquidation is the only solution (EC, 2012). A system with lower restructuring costs for SMEs could lead to better prevention of bankruptcy.

INSOL Europe (2013) mentions confidentiality of the pre-insolvency procedures as being an important aspect of prevention of bankruptcy. If all stakeholders were aware of its problems, the value of a company in financial distress may decrease as a result of the insolvency stigma. In addition, this may even threaten the continuation of the company.

However, it should be noted that certain studies indicate that an overly lenient system preventing business closures might not be optimal either. The example is from the US with a system allowing for restructuring, yet authors point out that in some cases this does not prevent the eventual closure of the business, but simply artificially prolongs its lifespan. Such inefficiencies are not economically optimal either as it results in an artificial maintenance of an underperforming firm (Baird and Morrison, 2005).

3.2 Available support measures to prevent bankruptcy



3.2.1 Prevention measures undertaken in different countries

We have identified several prevention measures in the 33 different countries, which we divided according to the steps illustrated in Figure 3.1. The full list with details of each measure and respective institutions can be found in Annex II.

Table 3.1 below illustrates graphically in which countries the above mentioned measures have been identified. At this point we would like to underline that the table does not evaluate the quality of different measures but serves as a simple comparative tool, illustrating the mere existence of such measures in different countries in Europe. It should also be noted that certain categories are not better than others, as they apply to companies in different situations, i.e. in different stages and levels of complexity of financial problems.

Table 3.1 Prevention measures around Europe

Countries concerned		AT	BE	BG	HR	CY	CZ	DK	EE	FI	FR	DE	EL	HU	IS	IE	IT	LV	LT	LU	MT	ME	NL	NO	PL	PT	RO	RS	SK	SI	ES	SE	TR	UK		
Identified measures																																				
Step A: Prevention measures	Information campaigns	YES	YES								YES													YES												
	Online information on prevention																					YES		YES	YES					YES						
	Early warning		YES									YES																					YES			YES
	Training																					YES														
	Automatic warning		YES									YES										YES														
Step B: Survival procedures	Free or sponsored consulting advice	YES	YES					YES	YES	YES	YES	YES			YES						YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	
	Out-of-court pre-bankruptcy settlement		YES	YES	YES		YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	
	Tax re-payment plans				YES																YES		YES													
	Free or sponsored legal and account services		YES						YES																											

Has the measure been identified in the respective country?
 YES  NO

Note: The table lists measures identified by independent country experts through desk research and interviews.

Step A: Prevention measures

In this group, we list those measures that are dealing with general prevention and identification of problems in early stages. They include³³:

- Information campaigns;³⁴
- Websites/online portals with information on prevention;³⁵
- Early warning (based upon accountants, banks etc.);³⁶
- Training;³⁷
- Automatic warning (based upon check of balance sheets);³⁸
- Advisory services

³³ More country specific details to be found in Annex V.

³⁴ E.g. Austria, Iceland, Poland, Portugal

³⁵ E.g. Malta, Netherlands, Norway, Slovakia

³⁶ E.g. Belgium, France, Spain

³⁷ E.g. Luxembourg, Poland

³⁸ E.g. Estonia

As illustrated in Table 3.1, measures focused on the very early stages of problems are not so common. Only in 16 countries out of 33 we have identified at least one of these specific measures. The most common (all identified four times) are information campaigns, online portals and early warning systems. The country with the most measures in place at the same time (three) is Belgium.

An example of an information campaign comes from the Brussels Centre des Entreprises en "Difficulté" (Belgium) that organises field permanencies together with local relays (municipalities, business centres, etc.) to proactively approach SMEs rather than wait for them to ask for help.

In Spain there is the "Relanza" programme, among others with the aim to prevent from bankruptcy. Each participating Chamber of Commerce offers a number of companies (20-25) the possibility of a general review of their financial status and other characteristics, and issues recommendations. So this is clearly meant to identify any problems at an early stage.

Step B: Survival procedures

At the next stage we focus on those measures that attempt to solve the financial problems that seriously influence the smooth running of a company. It is necessary to underline that in-court procedures are out of scope here. As survival procedures we identified³⁹:

Based on advice and voluntary agreements

- Free or sponsored consulting advice;⁴⁰
- Free or sponsored legal and accounting services;⁴¹

Based on the rule of Law

- Out-of-court pre-bankruptcy settlement (including mediation);⁴²
- Tax re-payment plans.⁴³

Table 3.1 clearly shows that Step B measures are more common. At least one measure exists in 30 out of 33 investigated countries. Consulting advice has been mentioned fifteen times, out-of-court pre-bankruptcy settlement nineteen times. It is again Belgium that applies most of the survival measures (three). It is a striking fact that countries focus on trying to solve existing problems, rather than intensively detecting them early when they are still small. However, as illustrated later in Section 3.2.3, the later the action, the higher the costs of prevention of bankruptcy.

A very good example of a support measure aiming to prevent bankruptcy comes from Denmark, where companies can contact the Early Warning centre when they face financial problems.⁴⁴ It is a *confidential* service. An Early Warning consultant screens the company and makes a first assessment. Thereafter, a lawyer specialised in insolvency is involved. If the company can still survive, a *volunteer* from the private sector is put on the case to help the company back on track.

A similar early warning service exists in Finland, called "Talousapu". It is a counselling service for entrepreneurs in financial distress. The services are provided online and by phone, and are *free of charge*. Twenty experts specialised in improving the financial health of companies are providing the service. From the start-up in 2009 until 2013 the service was partly financed by public funds and partly by private funds. As of 2014, the service is completely funded by the Finnish government.

³⁹ More country level details to be found in Annex VI.

⁴⁰ E.g. Denmark, Finland, Germany, Malta, Sweden

⁴¹ E.g. Belgium, Denmark

⁴² E.g. Croatia, Estonia, France, Greece, Hungary, Iceland, Italy, Latvia, Montenegro, Serbia, Spain, Romania, United Kingdom

⁴³ E.g. Croatia, Lithuania, Montenegro

⁴⁴ See <http://startvaekst.dk/earlywarning.dk>.

In Latvia, the tax authority identifies companies that are late with tax payments. This authority then suggests to extend the payment time and create a tax repayment plan. Companies do not have to wait for that, they can apply for the plan at the tax authority by themselves as well.

Box 3.1 Survival measure in the US

US Chapter 11 & Look back period

Under Chapter 11, the US law provides temporary protection from creditors and allows time for restructuring, rather having to directly enter into liquidation.

The “Look back period” (under the same chapter) provides protection from financial pressure of strong lenders. It states that if a company files for Chapter 11, all preferential transfers that occurred in the last 90 days have to be given back to the company. This means that a strong lender (such as a bank) upon learning of the company’s financial difficulty cannot demand its money back (even if it is entitled to them as a preferential lender). The aim is to prevent panic upon learning of the company’s situation and subsequent forced withdrawals by creditors, which worsens the situation and can lead to business failure (disadvantaging other creditors). It is a mechanism that protects the company from creditor pressures, while at the same time protecting all creditors equally from the company favouring single creditors.

3.2.2 Institutions taking care of prevention

The agencies, institutions or associations taking care of prevention vary across the European countries, and depend on the type of prevention measures that are offered. We can distinguish public and private institutions that are taking care of prevention. Public, such as ministries and government agencies, usually provide free advice. Private institutions involve chambers of commerce and consultancies.

From the side of **government institutions**, these are usually **ministries** of justice, economy, finance or enterprise/entrepreneurship that take care of the legal and policy background of “prevention”. Government institutions for example determine the possibilities for out-of-court settlement, the order of payment of creditors, the possibilities for a standstill period, legal consequences of a delay of payment, etc. In Greece, recently the “Government Council of Private Debt Management” has been set up with the purpose to closely monitor the implementation of policies for resolving issues related to debt of individuals and companies. In Ireland the focus is on debt resolution, and a special body has been established by the Ministry of Justice and Equality in 2013 (the Insolvency Service of Ireland), offering different kinds of debt solutions.

State or federal level **chambers of commerce** often offer some type of free consultation or try to raise awareness of prevention of bankruptcy (for example in Austria).

Some prevention measures are launched by **private initiatives**, such as the “Talousapu” service in Finland that is described above, which has developed into a publically funded and supported initiative. The Early Warning Centre from Denmark relies on **volunteers**. In France **sectorial associations** run their own prevention programs. The Belgian region Flanders has a special centre taking care of enterprises undergoing difficulties. In Denmark, **regional business development centres** are in charge of prevention. In Germany, the Kreditanstalt für Wiederaufbau (KfW, a **development bank**) finances and administers two prevention programmes. **Employers' organisations** can also be involved in the design of the measures (Finland). Of course, **private business consultants** (legal/financial) can always also be hired but their services are often not free.

Furthermore, **courts** are sometimes involved in out-of-court settlements, as pre-insolvency agreements sometimes need approval by courts or courts appoint a **mediator** to guide the out-of-court settlement procedure. In Malta and Montenegro, there are formal institutions for the latter procedure, called the “Mediation Centre” and “Centre of Mediation of Montenegro” respectively. In Latvia, out-of-court procedures do not require the involvement of the court. In Estonia, out-of-court settlement for companies is arranged through the Court of Arbitration at the Estonian Chamber of Commerce and Industry.

When a recovery plan has to be written, there are **advisers** like insolvency practitioners in charge of drafting the recovery plan, while **independent legal experts** may assess the feasibility of the plan.

Different parties can be in charge of alerting about the bad situation. It could be persons within the company itself (Slovakia), but also those lending and the experts in charge of monitoring, like the **accountants** and experts of the **tribunal de commerce** (France) or the **tax authority** (Latvia). In Belgium it is arranged by Law that accountants can act as early warning systems. Accountants are close to the company and have a good view on how well the company is doing. They should warn the Belgian Chambers of Commercial Inquiry if they notice difficulties within the company and the company does not react to the warnings of the accountant.⁴⁵ In Lithuania, the Centre of Registers collects important financial information on companies, which can be used for prevention.

Financial institutions are also a stakeholder acting in the prevention stage. Banks are often important creditors to small companies, and therefore also play a role in drafting the repayment plan in case of out-of-court settlement.

When prevention measures do not (yet) exist in a country, often reference is made to government institutions. For example, in Bulgaria the Ministry of Economy and Energy and the Bulgarian Agency for SME promotion are referred to as the institutions that ideally should in the first place deal with the issue of prevention. In Cyprus, a preparatory committee from the national government is currently studying the issue of prevention in order to make a legal amendment.

3.2.3 Costs of prevention and reorganization

The level of the costs of prevention are important as companies in financial distress do not have that much resources available to solve the problems. However, in the majority of countries the costs of prevention procedures are very hard to estimate. Indications differ widely because in some countries ‘prevention’ is understood as a consultation, while in other cases it means a complex re-organization of a company and in-depth expert advice. The procedures could also be confidential, so then the costs involved are not made publicly available as well (e.g. in France). Furthermore, the problem with the estimation of costs is the variety of cases and severity of problems that entrepreneurs face.

In general it can be said that there is a major difference in the level of costs for the entrepreneur between identification of problems and early warning on the one hand (Step A), and solving the problems to survive on the other hand (Step B).

When it comes to very early stage prevention, there are information campaigns and early warning systems etc. to raise awareness among entrepreneurs. This does not cost the entrepreneur any

⁴⁵ Belgian Federal Law on the Continuity of Enterprises (LCE) (WCO)

extra money. For example, accountants identify the problems when they are carrying out their normal tasks. In Estonia, there is an automatic warning system where annual financial statements have to be submitted electronically to the Commercial Register. The costs are close to zero, since the annual reports are submitted electronically and an algorithm issues the warning.

Approaching a call centre with some questions or initial legal counselling can still be for free (e.g. in the Czech Republic and Malta). It also happens that consultancy services are partly funded (e.g. in Austria and Iceland). The costs for the entrepreneur can become more significant when there are serious financial problems that need to be solved with the help of financial and/or legal advisors or mediators.

Although the costs of prevention are hard to estimate, some anecdotal indication of costs can be given. The following information all applies to Step B of prevention, i.e. survival procedures:

- In Croatia, the costs of a pre-bankruptcy settlement procedure are estimated to be between 1,000-1,300 EUR, depending on the size of the outstanding debt and the procedure taken.
- In Denmark, the price of a complex advisory process including a business consultant and legal advice is around 1,500 EUR, which seems relatively cheap since lawyers are giving advice for free and the system widely employs volunteers from the business community. In Denmark it is relatively easy to get business consultants to volunteer.
- In Germany, the KfW administers and finances the programs "Turn Around Consultancy" and "Round Table". The KfW offers financial support to companies in financial distress for the usage of external consultancy (mainly private consultants). The maximum eligible costs for a Round Table are around 1,600 EUR, while more advanced solutions in a Turn Around Consultancy can be up to 8,000 EUR. However, these are the costs funded by KfW, while German companies report total costs ranging from 50,000 EUR for small companies up to millions for larger companies.⁴⁶
- In Iceland the total costs for reaching an agreement between debtor and creditors can be as high as 11,000 EUR for the use of external experts. Approximately 3,000 EUR of this total is funded and provided by the Iceland Innovation Centre (mainly for improving processes).
- In Poland, the price of a full prevention program can vary between 23,000-59,000 EUR⁴⁷ depending on the size of the company.
- Sometimes the court needs to be involved in out-of-court settlement. In Czech Republic, court fees are about 38 EUR per hour, and solicitor fees are at least 13 EUR per hour.
- When companies make use of the "Talousapu" service in Finland, this generally requires between 2-8 working days (usually from a business consultant and/or a lawyer). The service is however free of charge for the company.
- For out-of-court settlement in Italy, in general four persons are involved. The time spent on such a procedure can vary from 100 to 1,500 hours of working time.
- In Serbia, the CFR procedure⁴⁸ concerns mediation driven negotiations (supported by the Chamber of commerce) between companies, banks and other major creditors. The costs per case range between 1,000-2,000 EUR for smaller companies and maximum 5,500 EUR for large debtors. There is also a pre-packed reorganisation procedure, which on average is more than two times cheaper compared to ordinary in-court procedures.

⁴⁶ In 2013 alone, 1,787 'Turn Around Consultancies' and 2,231 'Round Tables' were granted. Consulting services are mainly offered by private consultants. The costs of such services depend on the size of a company and the phase of distress it is in.

⁴⁷ The costs are for a full prevention programme (started in 2009), which is part of the Instrument of Quick Response created by Polish Agency for Enterprise Development's (PARP). Besides reorganization costs, it foresees training and advisory support for enterprises and employees coping with the negative results of economic downturn.

⁴⁸ CFR is the legal framework for institutional voluntary financial restructuring, adopted in 2011. Parties using the process are also entitled to various tax and other incentives not otherwise available.

- In Slovenia, the costs for “simplified compulsory settlement proceeding” are 10,000-15,000 EUR. For medium-sized companies going through a normal compulsory settlement proceeding, the costs involved are 30,000-40,000 EUR.
- Företagskuten is a free-of-charge consultancy service in Sweden for SMEs in financial distress. Each prevention case gets one consultant for 10 hours of consultancy work.
- In the United Kingdom, an insolvency practitioner may charge 2,000 GBP for the submission of an administrative order with some initial advice. Additional advice after submission of the order could be charged at 5,000-10,000 GBP. If a solicitor is engaged to review the work of an insolvency practitioner, 3,000-5,000 GBP may additionally be charged.

In general it can be concluded that the earlier the problems are identified, the easier they can be solved, and the lower the costs for the entrepreneur. Prevention of problems is always cheaper than solving them. Next to that, the larger the company, often the more creditors are involved, which also increases the costs of for example out-of-court settlement. However, it is significant that in some countries the level of prevention costs is quite low or even zero for initial support while in others costs are generally relatively high which, given the limited assets of a company in distress, reduces its chances of survival since it very probably is not able to pay for its rescue.

3.2.4 Survival rates of companies that have gone through prevention measures

For many countries there are hardly any statistics available on how many companies in financial distress have benefitted from prevention measures and how many of them survived thanks to the support. Some public support measures have been officially evaluated, so there it is possible to get numbers. Some prevention happens confidentially so in these cases there are no data available.

The survival rates mentioned widely differ from 1% (Turkey), 25% in Estonia, 25-40% in Croatia, to about 97% (Turn Around Consultancy - Germany) and 100% (PARP - Poland). However, the level of the survival rates of course also depends on the specific type of service, its visibility for entrepreneurs, the severity of the problems, etcetera.

The Danish Early Warning initiative, which was described above, currently helps approximately 600 companies annually. From 2007 up until 2010, about 1,500 companies had received help from Early Warning. Approximately 800 of these had completed the counselling programme, and about 60 percent of these companies survived at the time of the evaluation. The “Talousapu” service from Finland receives around 2,000 enquiries per year. More than a third of these enterprises have to file for bankruptcy in the end, which sometimes simply is the right decision. By keeping an unhealthy company alive, more money can be lost than when closing it down.

In Hungary companies have the option to make use of mediation. About 1 percent of the companies in distress use this option, and 50% of those are successful.

Some limited information is available from external sources. For example, INSOL (2013) mentions that the SIREVE⁴⁹ procedure in Portugal was used by 230 companies between September 2012 and June 2013. To compare: during the same period, in total 11,000 Portuguese companies underwent formal insolvency proceedings. No information is available yet whether these companies have reached agreements with the creditors.

⁴⁹ Sistema de Recuperação de Empresas por Via Extrajudicial (Out-of-court System for the Recovery of Undertakings).

3.3 Policy recommendations for more successful prevention of bankruptcy

Issues to be tackled

Interviewees from the 33 researched countries have been quite consistent in their views on what they consider as the most critical issues to be tackled for more successful prevention of bankruptcy of honest entrepreneurs.

Successful prevention is often not possible anymore because entrepreneurs are usually too late in asking for external help. It would be best if entrepreneurs take action or get assistance as soon as they observe the first signs of a financial weakness (in Step A). This would increase the recovery rate of creditors. However entrepreneurs do not ask for external help because of several reasons:

- Entrepreneurs want to fix the problems themselves instead of searching advice, because they are afraid of (i) losing control of their company or (ii) getting a stigma. It could be that they ask for (financial) help from family and friends first, before entering negotiations with the creditors.
- Their knowledge of financial planning and management does not suffice. This means that it takes the entrepreneurs too long to realise that there are problems and that they need help. The survival rate would be much higher if entrepreneurs became better at realising they face financial problems in time.
- Third, entrepreneurs are often not aware that support services for prevention of bankruptcy exist.

It was also mentioned several times by experts that the prevention measures should be as cheap as possible, as companies, in particular SMEs, in financial distress cannot afford expensive services.

Box 3.2 Embarrassment of entrepreneurs in the US

Research shows that consumers in the US are often very embarrassed to even ask their friends and family for help. Instead they try to fix the problem with more credit, mostly credit cards, only exasperating the situation.

Recommended Solutions

Although many countries already offer good services to prevent bankruptcies of their companies, even more bankruptcies can be prevented by focussing policy on the mind-sets, awareness and knowledge of entrepreneurs. In order for better prevention of bankruptcy:

- Encouraging entrepreneurs to take action at a very early stage of financial problems and creating the right environment to be able to do so.
 - As can be seen from table 3.2 this kind of action is lacking in the majority of the countries investigated (stage A); from the analysis it seems that countries at the moment deal with ex-post reaction, rather than ex-ante prevention.
 - It is important that at the moment a company decides to start preventive actions it is not penalised by panicked creditors pushing to retrieve their money and that it can make use of the right expertise for taking preventive measures.
 - It is therefore important to have access to expert advice at affordable costs and well signposted where it can be found. In this respect Belgium in particular can already be taken as a well-functioning example, other countries also have effective systems in place (for example Denmark, Finland etc.).

- Confidentiality should be guaranteed as one of the main issues companies face is publicity and the danger of panic by creditors. In this way we have identified the Dutch “secret curator” system as very apt.
 - A formalised legislative approach can be seen in the US with the “look back clause” in Chapter 11 as a very good examples of creating the right environment for prevention (for more information see Box 3.2).
- Offer of training on financial planning and management for entrepreneurs.
 - Entrepreneurial capabilities could be improved with financial management and financial prevention steps included in trainings for entrepreneurs.
 - It should be offered both to new starters as well as current entrepreneurs.
 - The training should not be too simplistic or of elementary. As previous examples from the US have shown such basic trainings proved to be too vague and not useful to the participants.
 - Topics to be covered should be carefully selected, but entrepreneurs should also be encouraged to engage with banks at an early stage of financial problems, as these are often the main creditors.
 - The Business Gateway in the UK does offer such training very well⁵⁰.
- Establishment of an (automatic) early warning system.
 - Quantitative models such as those used by PCSB could be used to detect companies in trouble. Or by use of delayed tax payments such as in Latvia.
 - The companies should be approached in a discrete and appropriate manner, such as by email or call informing the company whether it is aware of possible issues. It must be left to the entrepreneur or company to decide whether to continue such conversation or any other course of events.
 - Confidentiality must also be ensured.
 - The mechanism can be provided by a government body, agency, volunteers or even private companies (such as PCSBs) as long as certain minimal standards are applied (both regarding the model as well as the means of contact).
- Awareness raising on where to get the advice and support.
 - This can take many different forms and could be funded by both public and private resources.
- Introduction of preventive tax support measures.
 - If a company is facing temporary financial issues and tax is proved to be a tipping point, systems should be available to for instance delay tax payments.
 - Latvia is an example where such measure is already operational.
- "De-stigmatisation" of failure in entrepreneurship education (preferably at secondary school) it should be underlined that there is nothing wrong with failing as long as you are not fraudulent
 - It should be underscored that there is nothing wrong with failing as long as the entrepreneur is not fraudulent This would address the social stigma.

⁵⁰ <http://www.bgateway.com/>

4 Severity of bankruptcy procedures

4.1 Introduction

Bankruptcy procedures have a significant impact on the chance of an entrepreneur to start over. Lengthy and complicated procedures, that significantly impact an honest entrepreneur capital and reputation, drastically decrease the chance of starting a business again. In this sense an efficient and fair bankruptcy procedure is key in facilitating a second chance for honest entrepreneurs.

4.2 The efficiency of the bankruptcy systems

The 33 country experts have researched nine indicators on the entrepreneur-friendliness of the bankruptcy law procedures in their countries, which are:

1. Court neutrality;
2. Length of time of debt repayment plan;
3. Repayment plan as part of the bankruptcy court procedures;
4. Separation of judicial and administrative roles;
5. Creditors' committees;
6. Tax legislation increasing the recovery rate of creditors;
7. Average time of bankruptcy procedures;
8. Exemptions protecting the bankrupt entrepreneur⁵¹;
9. Non-financial consequences.

At this point we should underline that the indicators above belong rather to in-court procedures. However, it does fit into the scope of this study as court procedures have the aim to let the business survive if viable and hence prevent bankruptcy.

1. Court neutrality

We have defined court neutrality as follows: courts are defined as **not** neutral if they favour either debtors or creditors. The results of the country studies indicate that only in Italy and Norway there is no court neutrality, in the 31 other countries, courts are seen as neutral.

2. Length of time of debt repayment plan

Although the Competitiveness Council asked EU Member States to allow for a maximum period for debt settlement of 3 years by the end of 2013, the results from the country studies show that only in 11 countries (one third of total), the average time for debt plan repayment is less than three years. In Estonia there is no time limit for debt repayment. It could be that the time differs for businesses and private bankruptcies (non-incorporated enterprises).

For example in Austria, the length of time for corporate insolvencies is between 12 and 36 months, while for private bankruptcies this is longer than three years.

⁵¹ Such as primary residence not being counted, capital needed to perform a job (car, tools, computer etc).

3. Repayment plan, separation of judicial and administrative roles & creditor's committees

Table 4.1. below shows for each of the 33 countries whether:

- A repayment plan is a part of the bankruptcy court procedure;
- Judicial and administrative roles are separated;
- Creditor's committees exist in the formal court procedure.

As indicated in the table, the creation of a plan for repayment of outstanding debts is not always part of the bankruptcy procedure. Namely, according to our country studies, this is not the case in Belgium, Cyprus, France, Norway and Poland. A separation of judicial and administrative (government) roles exists in about two thirds of the countries (21 out of 33).

The possibility to have creditors' committees means that there can be coordination among creditors, which in theory increases the efficiency of in-court procedures. In the Netherlands the committee can be assigned after insolvency occurs but before the bankruptcy procedure. It takes the form of 1-3 members that can advise the insolvency administrator on how to proceed with the enterprise. However, in practice committees are rarely used in the Netherlands, despite the system being in place (Gispen, 2009). Only in five countries covered by our study, creditor's committees do not exist at all.

Table 4.1 Repayment plan, separation of judicial and administrative roles, creditor's committees

Country	Judicial and administrative		
	Repayment plan	roles separated	Creditor's committee
Austria	Yes	yes	not compulsory
Belgium	No	no	not compulsory
Bulgaria	Yes	no	not compulsory
Croatia	Yes	yes	compulsory
Cyprus	No	yes	compulsory
Czech Republic	Yes	yes	not compulsory
Denmark	Yes	no	do not exist
Estonia	Yes	yes	not compulsory
Finland	Yes	yes	do not exist
France	No	yes	not compulsory
Germany	Yes	yes	compulsory
Greece	Yes	no	compulsory
Hungary	Yes	no	not compulsory
Iceland	Yes	yes	not compulsory
Ireland	Yes	yes	do not exist
Italy	Yes	yes	compulsory
Latvia	Yes	yes	not compulsory
Lithuania	Yes	no	not compulsory
Luxembourg	Yes	yes	do not exist
Malta	Yes	yes	not compulsory
Montenegro	Yes	no	not compulsory
Netherlands	Yes	no	not compulsory
Norway	No	no	not compulsory
Poland	No	no	not compulsory
Portugal	Yes	no	compulsory
Romania	Yes	yes	not compulsory
Serbia	Yes	yes	compulsory
Slovakia	Yes	yes	not compulsory
Slovenia	Yes	yes	not compulsory
Spain	Yes	yes	not compulsory
Sweden	Yes	yes	do not exist
Turkey	Yes	no	compulsory
UK	Yes	yes	not compulsory

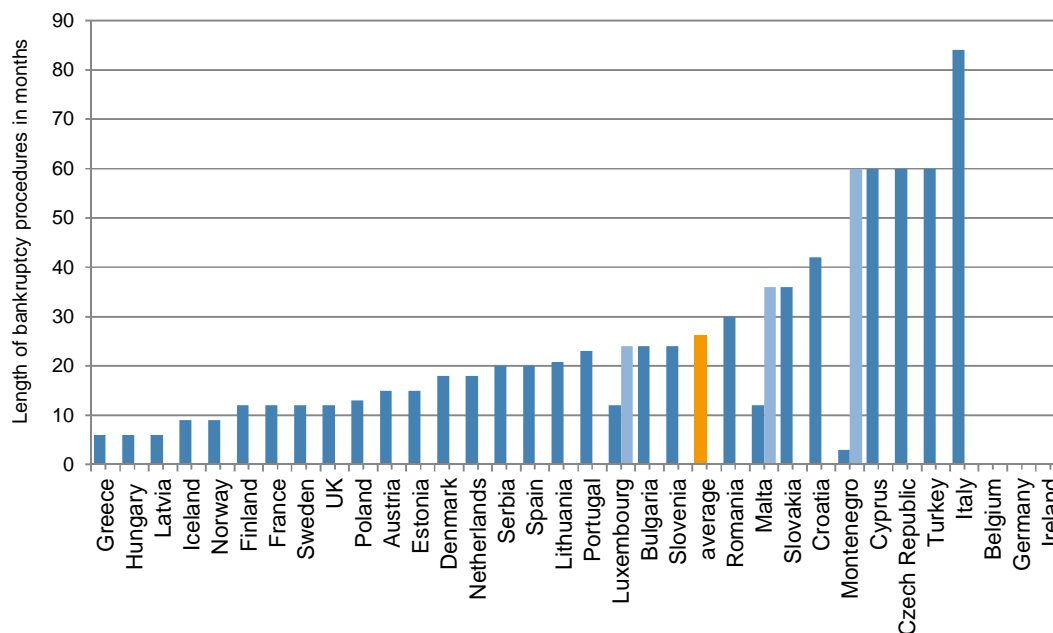
4. Tax legislation increasing the recovery rate of creditors

In 12 of the 33 countries, there exists tax legislation increasing the recovery rate of creditors. An example of this comes from Spain, where they have “VAT recovery”. This means that during the first month of insolvency procedures, creditors may claim a refund of VAT on unpaid amounts.

5. Average time of bankruptcy procedures

Figure 4.1 below presents the average length of bankruptcy procedures as mentioned by the interviewees in all 33 countries.

Figure 4.1 Average length of bankruptcy procedures in months



N.B. Belgium, Germany and Ireland were not able to provide an average length of bankruptcy procedures.

The average length of bankruptcy procedures is about 26 months, so slightly more than two years. For three countries, Greece, Hungary and Latvia, the bankruptcy procedures are often only half a year, while in countries like Cyprus, Czech Republic, Turkey and Italy, the procedures often take more than five years.

Many country experts have indicated that it is difficult for the interviewees to give an average length of the bankruptcy procedure. This is because the length of the procedure depends on many factors, such as the complexity of the case, the size and legal form of the enterprise, the number of creditors, the honesty/dishonesty of the entrepreneur, the spread of the assets across multiple countries, etcetera. Therefore, five countries were not able to provide us with an average length (Belgium, Germany, Ireland, Luxembourg, Malta and Montenegro), but Luxembourg, Malta and Montenegro were able to provide a range. In Figure 4.1. In this is presented as two columns per country, where the left column represents the lower value of the range and the right column represents the highest value of the range.

6. Exemptions protecting the bankrupt entrepreneur

We have investigated the exemption of certain assets from bankruptcy proceedings, as this can make would-be entrepreneurs more willing to start a company as the (personal) consequences related to a potential bankruptcy are less severe. However, only in a slight majority of the countries (19 out of 33), certain categories of assets are exempted from bankruptcy proceedings. Examples of exemptions are:

- residential house or apartment;
- certain percentage of the minimum income (welfare assistance);
- objects considered elementary for living (such as a bed and fridge);

- clothes;
- basic furniture;
- certain personal belongings;
- items that are required to remain in business (tools of trade, vehicles)⁵².

Box 4.1 Exemptions in the US

Small businesses and exemptions: The US reality

In the United States, if an entrepreneur goes bankrupt, certain assets are exempted from the bankruptcy procedures, which is guaranteed by the law. These are the assets needed for day to day living, such as personal property. However, in reality this rule is often bypassed by banks, who take advantage of the fact that if an entrepreneur voluntarily pledges these assets to increase the financing of his company the exemptions do not apply anymore. Small business and sole entrepreneurs, usually highly dependent on loans in early stages of their businesses, are thus forced by banks to pledge their personal assets in order to obtain necessary funding. In that case, a bankrupt entrepreneur is left with nothing and the protection given by the mechanism of exemptions does not fulfil its mission anymore.

7. Non-financial consequences

In case the consequences of a bankruptcy are only in the financial sphere, would-be entrepreneurs would have more incentives to start a new business as the (personal) consequences related to a potential bankruptcy are less severe, just like in the case of "Exemptions". In 15 countries from our study, there are more consequences than financial ones only. Examples of consequences mentioned are:

- interdiction to take a director position in a company for a certain number of years;
- disqualification from positions of public office or a role that requires financial oversight;
- withdrawal of certain licences.

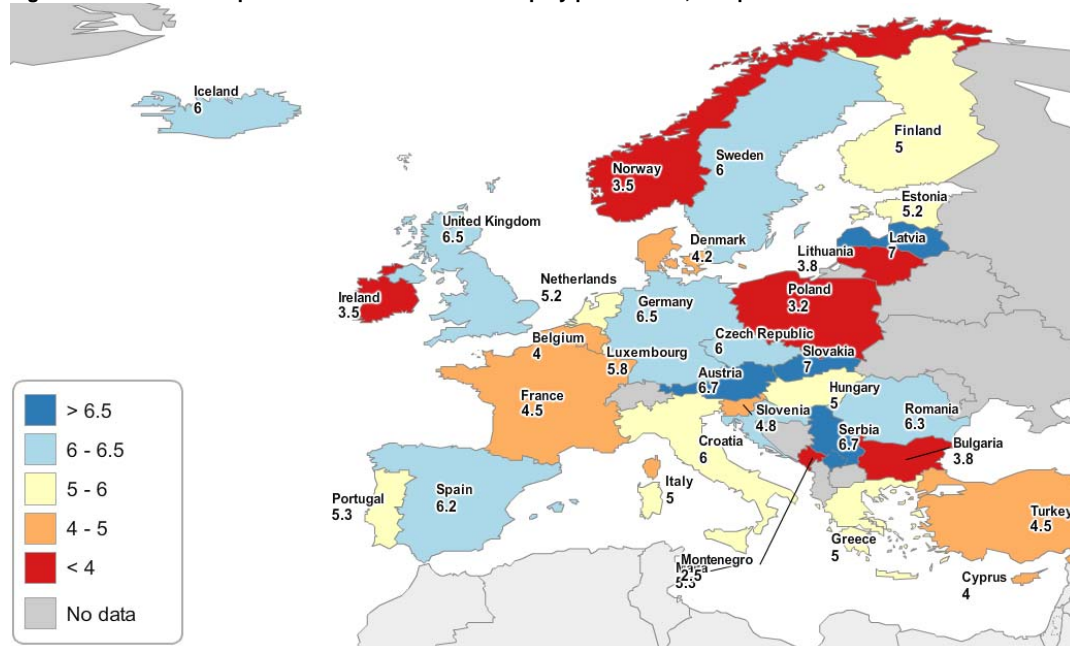
A different type of non-financial consequence that is often mentioned, but which does not follow from official rules or regulations is that the bankrupt entrepreneur often, "unjustifiedly", gets the stigma of being fraudulent.

Severity of bankruptcy procedures composite index

For all nine abovementioned indicators, scores have been assigned per indicator per country, where countries can score up to 1 per indicator, where zero is worst and 1 is best. For each country, we have constructed a composite index, which is calculated as the sum of these nine scores for each country. The index can be compared across countries and it measures the (non-) severity of bankruptcy procedures in the country. Countries with a high score have a more entrepreneur-friendly bankruptcy system compared to countries with a low score, whose bankruptcy system is seen as more severe. The composite indices are presented in Figure 4.2.

⁵² In the US pensions are also included in this since due to the lack of substantial state pension system, private pensions are considered as necessities, rather than additional money (as is more the case in Europe).

Figure 4.2 Entrepreneur-friendliness of bankruptcy procedures, composite indices



N.B. Because Belgium, Germany and Ireland could not provide us with an average length of their bankruptcy procedures, and because Serbia does not have bankruptcy procedures for entrepreneurs, we assigned them average values in their category.

Based on this scoring and mapping, we observe that particularly Austria, Latvia, and Slovakia have a high score and can thus be seen as having the most entrepreneur-friendly bankruptcy systems, as they have a score of more than 6.5. From our results and scoring model, the systems of Poland and Montenegro come out as the least entrepreneur-friendly.

4.3 Policy recommendations for more honest entrepreneurs-friendly bankruptcy procedures

Issues to be tackled

With regard to the investigation in 33 countries, we found that fast procedures favouring honest entrepreneurs are not always the case. Courts appear to be neutral, however bankruptcy procedures could last unreasonably long and a smart system of exemptions is often not the case.

In the above analysis on the severity of bankruptcy procedures, we observed a lot of differences across countries. Two specific recommendations can be drawn from this analysis, which could greatly benefit the second chance for honest entrepreneurs, are the following:

- Create an efficient system of exemptions
 - The exemptions would protect an entrepreneur from losing his/her basic living necessities (exemption of personal assets and housing) and in some cases enable him an easier second start (exemption of certain assets needed for business).
 - The different exemptions should be set and clearly agreed on in a harmonised way.
 - Measures ensuring that this protection will not be bypassed should be ensured (viz. loophole identified in the Box 3.1.)
 - In this way not only would entrepreneurship be incentivised, but also the social stigma be addressed, where the entrepreneur would be less affected in his/her social life.
- Limit the non-financial consequences of bankruptcy
 - The existence of non-financial, often personal, consequences of bankruptcy like withdrawal of certain licenses or the interdiction to take a new director position have implications. Firstly, the second chance

after bankruptcy is hindered. Secondly, would-be entrepreneurs are less incentivised to start a new business as the implications of failing are more severe.

- It is advised that the rules on the consequences are made applicable only to fraudulent entrepreneurs, for which these consequences are of course appropriate.

5 Ease of second chance after bankruptcy

5.1 Introduction

The stage of “post-bankruptcy and second chance” is recommended by the 2011 Expert Group Report as the second priority intervention area for policy makers in EU Member States to support SMEs, after “prevention of bankruptcy”.⁵³ Therefore, in this chapter we will analyse the possibilities for second chance and the support measures available in the 33 countries, and identify the particular aspects where policy makers could play a role in improving the possibilities for a second chance for honest bankrupt entrepreneurs.

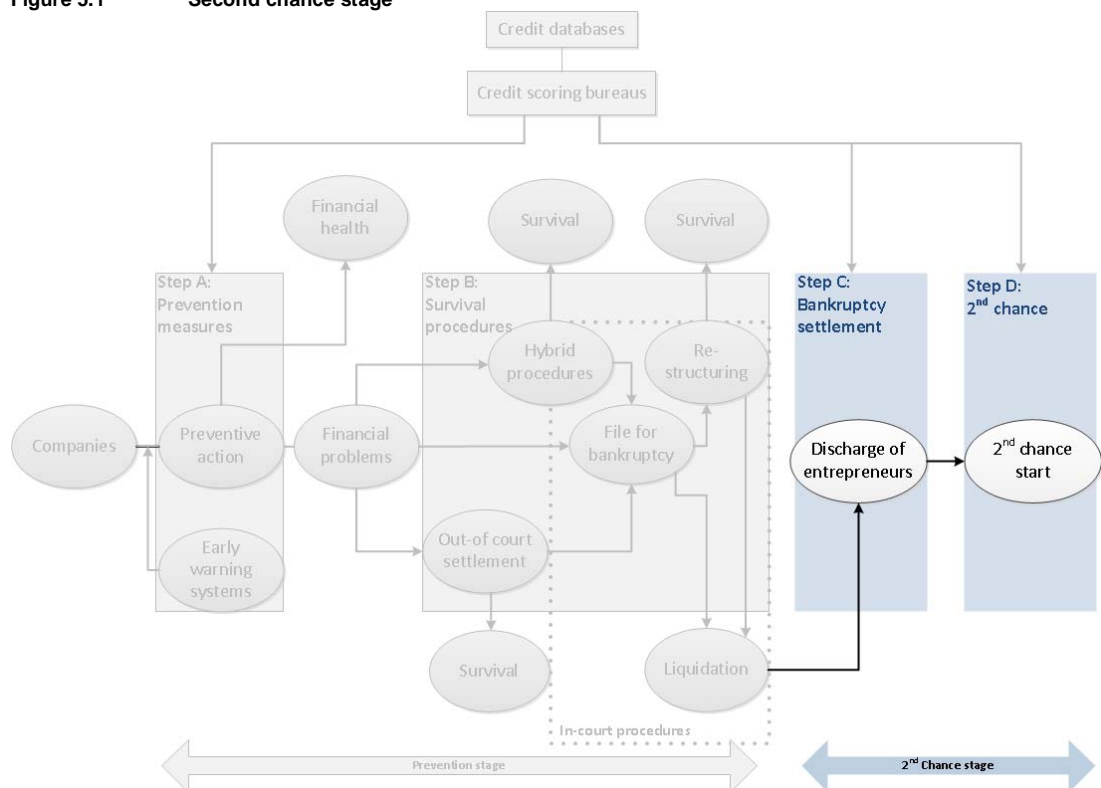
Like the previous chapter, this is again done based on literature and country specific information gathered by the 33 country experts. For the second chance stage, we assume two possible steps that follow unsuccessful attempts to save a company, once the filing for bankruptcy and liquidation took place. These are:

Step C. Bankruptcy settlement, e.g. discharge procedures;

Step D. Second chance support, e.g. access to finance or coaching.

Figure 5.1 below again provides the overview of the bankruptcy process for entrepreneurs, and highlights the stage that we will focus on in this chapter.

Figure 5.1 Second chance stage



Source: Ecorys

⁵³ Final Report of the Expert Group (EC, 2011).

Making a Successful Second Chance Possible

The literature hints to some aspects that need to be addressed to offer a second chance to honest bankrupt entrepreneurs. These aspects have been taken into account in the country studies.

In many countries, honest bankrupt entrepreneurs are treated the same way as fraudulent entrepreneurs, although fraudulent entrepreneurs represent only 4-6% of total bankruptcies (Calogirou et al, 2011). Because of this treatment, honest entrepreneurs run the risk of being marked with the social stigma that is related to bankruptcy; furthermore they face legal and administrative barriers for restarting, and have problems with accessing finance for the new enterprise. The stigma attached to failure can inhibit would-be as well as bankrupt entrepreneurs to restart (Burchell and Hughes, 2006). So a differentiation in the treatment of honest and fraudulent entrepreneurs is crucial for an effective second chance.

When there are good mechanisms in place to identify dishonest entrepreneurs, creditors have some safeguards. Thereby these mechanisms help honest entrepreneurs to get a second chance after bankruptcy because investors or funds can be sure about their honesty and good intentions. Next to that, honest entrepreneurs can become beneficiaries of second chance support programmes (if available). At the same time such systems avoid unfair competition and moral hazard after bankruptcy (EC, 2011) as it limits the opportunities of dishonest entrepreneurs to continue their bad behaviour while at the same time benefiting from support services for (re-)starters.

An effective second chance is also limited by lengthy and expensive bankruptcy procedures. The more time it takes, the more value is lost⁵⁴. Faster processes for honest entrepreneurs are therefore important and this is another argument for differentiation between honest and dishonest bankrupt entrepreneurs. World Bank data show that there is a relationship between the length of insolvency procedures and the loss of company value (EC, 2011).

Important for supporting second chance is discharge, and in particular the time to discharge (the time between liquidation and formal cancellation of debt). Differences regarding discharge exist between countries:

- Automatic discharge for honest entrepreneurs immediately after liquidation;
- Application for a discharge needed;
- No possibilities to obtain discharge (EC, 2012).

To really give entrepreneurs a second chance, discharge should be as automatic as possible (EC, 2011). Also the IMF (2013) calls for a fresh start for financially responsible individuals through discharge from the liabilities at the end of bankruptcy procedures, as one of the key features of efficient personal insolvency law.

Several studies have found a direct correlation between the entrepreneurial activity, investment and the efficiency of a country's bankruptcy system. This is to say that the more efficient the bankruptcy procedure is in terms of time, cost and recovery rate, the more credit is available to entrepreneurs as well as the higher the Investment/GDP ratio is (Succurro, 2012). Such findings are unsurprising since good and efficient governance decreases the risks to invest and therefore the more attractive it becomes to invest or become an entrepreneur.

⁵⁴ <http://www.euractiv.com/innovation-enterprise/bankrupt-companies-get-second-ch-news-502496>

5.2 Ease of the second chance

Based upon data collected in 33 countries, we report on seven indicators that evaluate the ease of second chance in the case that a bankrupt honest entrepreneur wants to start over. These indicators are:

1. Difference in treatment of honest vs. fraudulent entrepreneurs;
2. Special procedures for SMEs;
3. Possibility to get full discharge;
4. Period of time to obtain discharge;
5. Possibility of automatic discharge;
6. Period of time of negative scoring is being maintained / documented;
7. Deleting from a credit database after discharge.

The basic premise is that a faster and more efficient discharge enables entrepreneurs to start over again with a clean slate.

1. Difference in treatment honest vs. fraudulent entrepreneurs

The country studies show in the majority of the EU Member States, both honest and fraudulent entrepreneurs are treated the same way in the bankruptcy process. In this respect, only 30 per cent of the European countries treat the two groups differently. We assume that the equal treatment of these two groups discourages the honest ones to do business again since it adds to their stigmatization.

Although within the bankruptcy law both honest and fraudulent entrepreneurs are treated in the same way, criminal law could apply to dishonest entrepreneurs. For example in Austria, entrepreneurs who were convicted because of intentional insolvency offense are not eligible for a “Sanierungsplan” or an “Abschöpfungsverfahren”.

Furthermore, although the bankruptcy process is equal for honest and fraudulent entrepreneurs, the consequences are often different. For example in Lithuania, in contrast to honest bankrupt entrepreneurs, dishonest entrepreneurs may be barred from taking a director position for 3-5 years.

Box 5.1 Treatment of dishonest entrepreneurs in the US

In the US, if an entrepreneur is found to be “dishonest” not only will he/she not be eligible for part of the debt to be written off, but he/she will also not be eligible for discharge from records and databases. In the most severe case he/she will also be criminally liable (such as in the case of Enron and its jailed executives).

2. Special procedures for SMEs

Special procedures for SMEs mean faster or cheaper bankruptcy procedures for this group of enterprises and their owners. Although the special procedures are technically not a part of the second chance stages, the indicator has been placed here, because the literature review has shown the importance of fast/cheap procedures for a good new start (see section 5.1). Namely, the more time and money a bankruptcy procedure takes for entrepreneurs, the less money and energy are left to invest in a new start-up company. However, unfortunately specific fast-track or less expensive procedures for SMEs are not an existing practice. Only seven countries (Croatia, Czech Republic, Luxembourg, Romania, Serbia, Slovenia and Spain) offer this possibility.

3. Possibility to get full discharge

Honest bankrupt entrepreneurs can obtain full discharge in all examined countries except for Serbia, where no bankruptcy procedures for entrepreneurs exist⁵⁵. In 18 countries, discharge proceedings are compulsory, in 12 countries they are not. Norway and Latvia make a distinction in the matter of discharge between natural and legal persons.

Although there is a possibility for the entrepreneurs to get discharged, the question is what is left for the entrepreneur after the court procedures and liquidation. For example, in Hungary discharge is automatic for honest entrepreneurs *after* the decision of the court on the debt settlement. Then the court immediately proceeds to discharge. In Bulgaria, full discharge is achieved when all the creditors are satisfied or the assets of the company are exhausted. Some countries only recently started with discharge for entrepreneurs. For example in Spain, discharge is now being introduced for natural persons, as established in Spanish Law 14/2013.

Next to that, there could be exceptional cases in which full discharge cannot be obtained although the option is in principle available. For example in Estonia, it was mentioned that there are no possibilities for getting discharged if one already has undergone full discharge in the past 10 years, or if one has committed an insolvency related crime. In Lithuania, several categories cannot be discharged, for example alimony for child support or fines the debtor has to pay to the state for administrative law violations.⁵⁶

In Norway, persons (i.e. entrepreneurs) can only apply only once in their life for discharge of all debts. Often it tends to be difficult to obtain discharge, as the bankrupt entrepreneur must prove that he/she has done everything to repay the debt him/herself, and that the debt is unsurmountable.

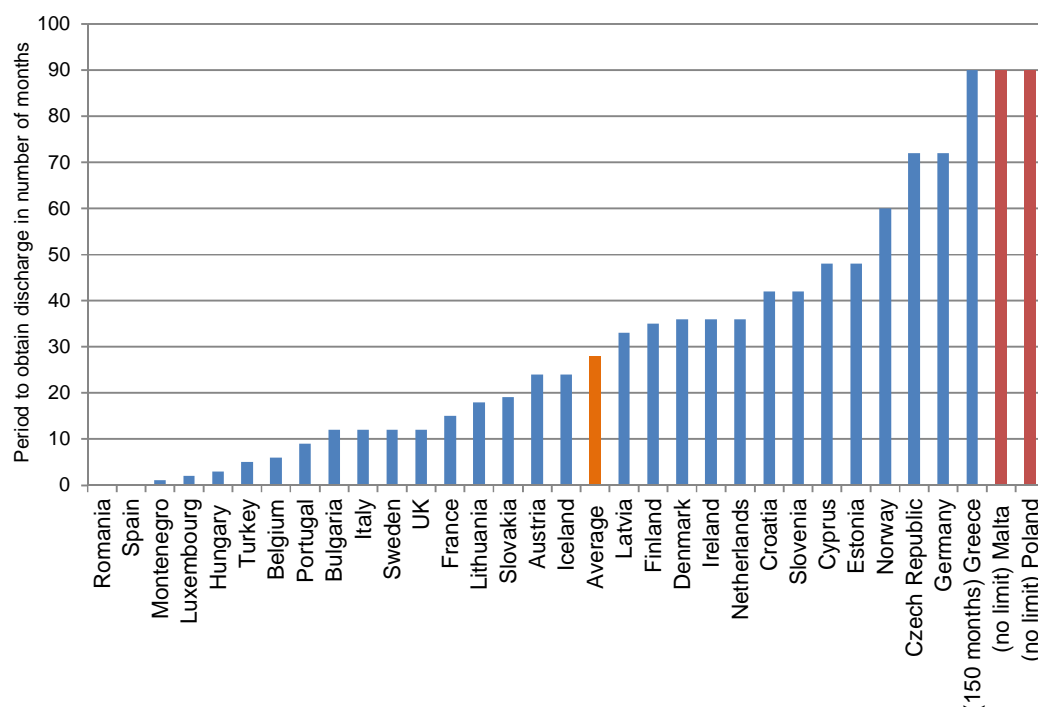
4. Period of time to obtain discharge

The average time to obtain a full discharge after the moment when liquidation is official is 28 months. This average is calculated over data for 30 countries instead of 33, as Serbia, Malta and Poland are not included in the calculation of the average. Serbia has no bankruptcy measures and in Malta and Poland, no time limit is given by law so therefore it is hardly possible to calculate an average. The average length of the period to obtain discharge in all the European countries is shown in Figure 5.2 below.

⁵⁵ In Serbia entrepreneurs do not have a possibility to get discharge. They are liable for all obligations incurred in connection with the pursuit of the business activity with their entire assets, including any assets they acquire in connection with the pursuit of the business activity. Furthermore, liability for the obligations does not cease upon deletion of an entrepreneur from a register.

⁵⁶ According to the Law on Natural Persons Bankruptcy.

Figure 5.2 Period of time to obtain full discharge



N.B. The information in this figure does not show the maximum legal period of discharge per country, but concerns the average period to obtain discharge in number of months which is calculated as the average of the length mentioned by the interviewed stakeholders per country.

In some countries like Romania and Spain, where discharge is immediate, or Montenegro, Luxembourg and Hungary, where it takes only 3 months and less, the process for *honest* entrepreneurs *after official liquidation* is fast and efficient. Contrary to this, in the Czech Republic, Germany and Greece, where it lasts 70 months or more, the whole discharge becomes lengthy and therefore discourages entrepreneurs to start again after the cumbersome procedures are finished. The unlimited discharge timeframe in Malta and Poland is highly unfavourable towards honest bankrupt entrepreneurs who wish to start a new business.

5. Automatic discharge

With the exception of Serbia (which has no bankruptcy procedures), in half of the European countries the discharge is automatic, meaning that there is no necessity to re-apply at court. For example in Austria, the payment of the quota agreed upon in the enterprise insolvency proceeding automatically leads to discharge and does not require an additional court decision. Automatic discharge decreases the administrative burden imposed on entrepreneurs in the course of bankruptcy procedures, and makes the whole discharge process smoother. Therefore we assume that in the countries with automatic discharge without quotas, a second chance start becomes easier.

6. Period of time of negative scoring

The period of negative scoring means the time until the undergone bankruptcy does not influence the score of an entrepreneur in a private credit scoring database anymore. Even if this issue technically belongs to the chapter on credit scoring agencies, we decided to include it as an indicator of an easy second chance since the score directly influences the conditions under which an *honest bankrupt entrepreneur* can start over again. For more details see Chapter 5.

For an easy overview, we divided the European countries into four categories according to the length of the period of negative scoring. This division is illustrated in Table 5.1 below.

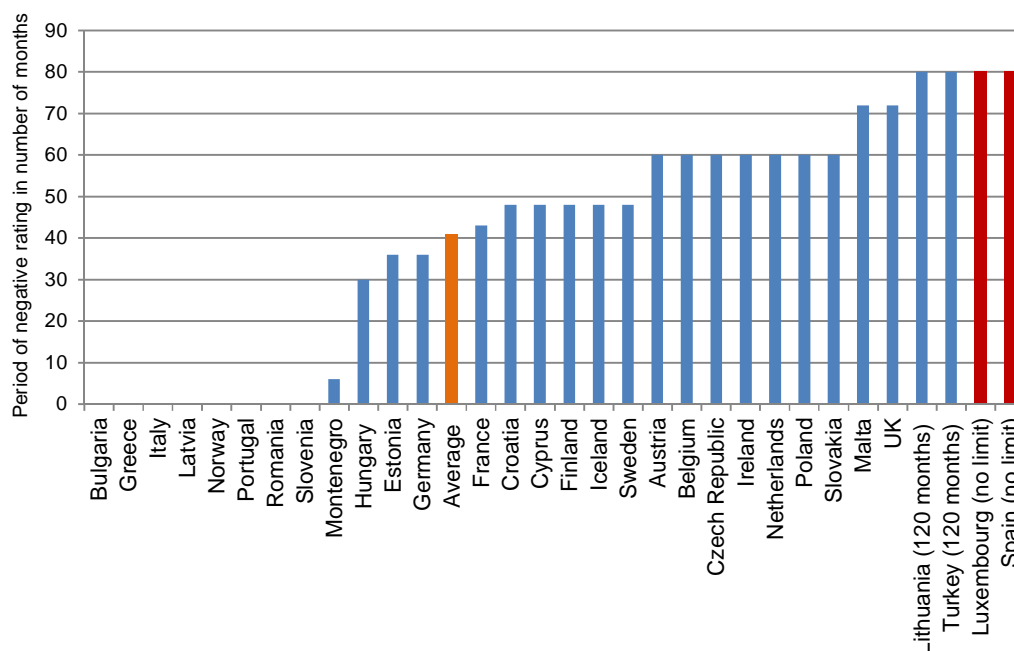
Table 5.1 Categories of periods of negative scoring

Period	Duration of negative rating*	Countries
Very long or unlimited	72 months and more	Lithuania, Luxembourg, Malta, Spain, Turkey, UK
Long	60 months	Austria, Belgium, Czech Republic, Ireland, Netherlands, Poland, Slovakia
Medium	30-48 months	Croatia, Finland, France, Germany, Hungary, Cyprus, Estonia, Iceland, Sweden
Very short or zero	0-6 months	Bulgaria, Greece, Italy, Latvia, Montenegro, Norway, Portugal, Romania, Slovenia

*) None of the countries reported a negative scoring in the 7-29 months period.

It can be observed in Figure 5.3 that in some countries, the negative score is “erased” nearly immediately what makes start of a new business much easier. On the other hand, for example in Lithuania and Turkey, the negative scoring remains with an entrepreneur for years and therefore poses an obstacle for example when it comes to access to finance. For Denmark, it is impossible to estimate an average duration of a negative scoring since its length significantly varies according to different industries. On average in 32 countries it takes about 40 months until a negative score is removed after discharge.

Figure 5.3 Period of time the negative scoring stays with an entrepreneur



7. Deleting from a credit database after discharge

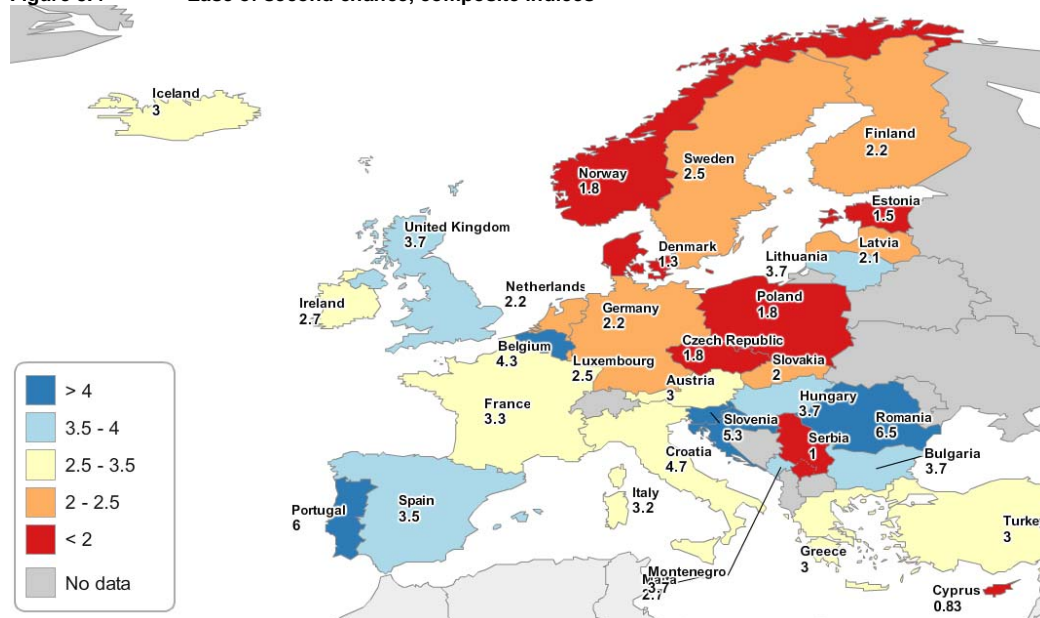
In most of the countries, an entrepreneur remains in a private/public credit database at least one year. This is the reality in 75% of countries where such a database exist. There are no discharge procedures and no databases in Serbia. In Italy, the public registers have been abolished by law, while in the Netherlands no credit databases are allowed.

In Austria, there is a distinction between public databases, from where the record is deleted immediately, and private ones, where it remains for 7 years. Only in Bulgaria, Poland, Portugal, Romania and Slovenia, honest bankrupt entrepreneurs are deleted from databases almost immediately after their debts have been settled. More details may be found in Chapter 5.

Ease of second chance composite index

For all seven abovementioned indicators, scores have been assigned per indicator per country, where countries score up to 1 per indicator, where 0 is worst and 1 is best. For each country, we have constructed a composite index, which is calculated as the sum of these seven scores for each country. Therefore this index varies from 0, for the least friendly countries and 7, for the countries with the easiest restart after bankruptcy, and allows for easy comparison of countries across Europe. In countries with a high score it is more easy to start over (for honest bankrupt entrepreneurs) compared to countries with a low score, where chances to successfully do a business again are rather low.

Figure 5.4 Ease of second chance, composite indices



On the map above we can see that Romania (6.5), Portugal (6), Slovenia (5.33) and Croatia (4.66), appear as the countries with the easiest restart after bankruptcy. On the contrary, Cyprus (0.33), Estonia (0.67) and Norway (1) are the countries where entrepreneurs face many challenges if they decide to do business again after their bankruptcy. Because Denmark and Serbia could not provide us with an average length of discharge we could not calculate a composite index for these two countries.

5.3 Available measures facilitating a second chance

5.3.1 Second chance measures existing in different countries

The country experts have searched for available support measures on second chance in the 33 countries. Following our definition of different steps we can divide these measures into bankruptcy settlement and discharge (Step C) and second chance advice and support (Step D). The full list including details and respective institutions can be found in Annex II.

Table 5.2 below illustrates graphically in which countries the above mentioned measures have been identified. At this point we would like to underline that the table does not evaluate quality of different measures but serves as a simple comparative tool, illustrating the situation around Europe.

Table 5.2 Second chance measures around Europe

Countries concerned		AT	BE	BG	HR	CY	CZ	DK	EE	FI	FR	DE	EL	HU	IS	IE	IT	LV	LT	LU	MT	ME	NL	NO	PL	PT	RO	RS	SK	SI	ES	SE	TR	UK		
Identified measures																																				
Step C: Bankruptcy settlement	Advice services on discharge procedures																																			
	Efforts to simplify or shorten discharge																																			
	No fin. consequences for honest sole traders																																			
	Retaining items for a new business																																			
	Recovery proceeding																																			
	Assistance in debt negotiations																																			
Step D: 2nd chance	Access to start-up finance																																			
	Assistance with access to finance																																			
	A new company during bank. procedures																																			
	Awareness raising																																			
	2nd chance coaching and education																																			
	Cancellation of a rec. in a publ. database																																			
	Guidelines for re-starters																																			
	Public support measures																																			

Has the measure been identified in the respective country?

 YES  NO

Note: The table lists measures identified by independent country experts through desk research and interviews.

In general we can say that tailor-made provisions for second chance starters are not very common around Europe. Some countries, such as Bulgaria, Croatia, Finland, Poland, Spain or Sweden, are observing the topic more closely and currently work on preparations of such measures. With the exception of Spain where the legal changes foresee creation of info-points advising entrepreneurs how to set up and close a business, the details of upcoming measures are yet unknown.

In a number of countries, there are no second chance provisions at all, no institutions and no obvious efforts to change this situation. This is the case in Austria, Hungary, Greece, Norway, Serbia and Turkey. We should also clarify that in some countries they consider in-court proceedings such re-organization plans as a part of the second chance – this is for example the case of Montenegro.

Interestingly, if we compare Table 5.2 and Table 3.1, we observe that for prevention there is less variation on the types of measures that are available, but they occur more frequently as more countries provide them. On the contrary, for second chance we have found the opposite to be the case, where the variation between types of measures is high, but they are less frequent.

Step C: Bankruptcy settlement

At this stage we focus on those measures that follow bankruptcy itself. These can influence how smooth and fast the discharge procedures are and under which conditions an entrepreneur can start again. As bankruptcy procedures we identified⁵⁷:

- Recovery proceedings;⁵⁸
- Efforts to simplify or shorten discharge;⁵⁹
- Honest individual entrepreneurs do not have to face financial consequences;⁶⁰
- Possibility to retain items needed for a new business;⁶¹
- Assistance in debt negotiations;⁶²
- Advice services on discharge procedures⁶³.

As illustrated in Table 5.2, a good number of countries (7 out of 33) attempts to shorten or simplify discharge. All other measures exist in one single country only. The majority of the investigated countries (22 out of 33) does not have any type of bankruptcy settlement measures. Only Slovenia applies two of the identified measures.

Denmark and Ireland have, for example, recently shortened the discharge period to three years only – after that an entrepreneur may freely start new business activities. A new three-year limit for the full discharge has been introduced also in Ireland. What helps entrepreneurs is also assistance in the course of debt negotiations. This is the case in France, where help and advice is targeted also to micro and small enterprises or agricultural activities.

In Slovenia, honest bankrupt entrepreneurs can ask the court to leave them with assets needed for a start of a new business. Interestingly in Romania, honest bankrupt entrepreneurs do not face any consequences at all and can start a new business without any problems the day after the court procedure has ended.

⁵⁷ More country specific examples can be found in Annex V

⁵⁸ Bulgaria, Spain

⁵⁹ Cyprus, Czech Republic, Ireland, Denmark, Italy

⁶⁰ Romania

⁶¹ Slovenia

⁶² France

⁶³ Belgium, Slovakia

Step D: Second Chance

As the last step, we analyse measures that help entrepreneurs who decide to re-open their business. They are supposed to support those, who do not give up after the initial failure and did not go bankrupt due to fraudulent behaviour. Examples of Step D measures include⁶⁴:

- Equal access to start-up finance;⁶⁵
- Assistance with access to finance;⁶⁶
- Public support measures;⁶⁷
- Guidelines for re-starters;⁶⁸
- Awareness raising;⁶⁹
- Efforts towards cancelation of a record in a public database;⁷⁰
- Individual can start a new company even while in the course of bankruptcy procedures;⁷¹
- Second chance coaching and education.⁷²

Table 5.2 shows that one of the very common measure is equal access to start-up finance that appears in 10 out of 33 investigated countries, followed by public support measures identified in six countries. We can find at least one measure in more than half of the European countries. The country that applies most of the measures is Germany (five measures), followed by France and Lithuania (three measures each).

In Lithuania, the focus is on awareness raising and the presentation of “second chance” success stories that would help public to perceive an *honest bankruptcy* as a common event that could happen to any business. In Germany, the Federal Ministry of Economics offers guidelines to re-starters. In France, an indicator called ‘FIBEN 040’ that used to pinpoint entrepreneurs years after their bankruptcy, has been recently cancelled.

Some Belgian associations offer free coaching on how to start a business again. This is also the case of Germany, where entrepreneurs can obtain financial support to hire an external consultant. In Luxembourg, it is the Chamber of Commerce that organizes seminars on company administration for those who were allowed to re-open their business after bankruptcy after an investigation of the General Prosecution.

In a large number of countries the results highlighted that after discharge, honest entrepreneurs are not discriminated when it comes to access to start-up finance and public grants. In Belgium, a mixed financial instrument is available for starting companies, in France an association ‘Initiative France’ helps to fund creators and those having difficulties. In the UK or Malta, any debts are associated with the company only and therefore an individual can easily start over even if being engaged in the company in bankruptcy procedures. In France, public organizations directly help entrepreneurs with their debt negotiations.

⁶⁴ More country specific examples can be found in Annex V

⁶⁵ Belgium, Iceland, France, Germany, Netherlands, Lithuania, Malta, Portugal, Spain, Sweden

⁶⁶ Ireland

⁶⁷ Estonia, Germany, Latvia, Lithuania, Spain, Sweden

⁶⁸ Germany

⁶⁹ Croatia, France, Germany, Lithuania

⁷⁰ France

⁷¹ Malta, Slovenia, UK

⁷² Germany, Belgium, Luxembourg

5.3.2 Institutions taking care of second chance

Since there are almost no second chance measures, it is hard to indicate institutions dealing with them. However, we may identify certain patterns when it comes to institutions and second chance measures they provide or support.

When it comes to **government institutions**, these are usually Ministries of Justice and Ministries of Economy. These are responsible for the close observation of the issue and initiation of any legal changes. They often provide guidelines, such as the Ministry of Economy and Energy in Germany, where all new starters no matter their history can also benefit from loans with reduced interest rates from the public business development bank.

There is an important role played by **national or federal associations and agencies**. These are usually those who assist entrepreneurs in any stage of their business. They may offer consultancy and advice during both discharge procedures and facilitation of a new start. Also, they are the common providers of start-up finance. As an example we can mention:

- National Business Promotion Agency Lithuania, that promotes second chance and provides new starters with various support measures;
- “Tussenstap” Vlaanderen assisting entrepreneurs during discharge procedures and assisting them with consultancy;
- Initiative France that has mixed financial instruments available.

Private initiatives are limited to private consultancies in terms of business administration, accounting or legal matters. Costs are usually paid by the entrepreneurs themselves. In Germany it is possible to obtain public support for such a service and non-profit organizations also organize self-help groups and information events. In Slovakia, the initial meeting and the first advice of private consultancies (provided for example by chambers of commerce) is free of charge.

Those who are often mentioned as involved in second chance measures are **courts**. They have a significant influence when it comes to discharge procedures and debt settlement. However, the involvement of courts is of a rather practical nature, they are not involved in the policy matters and promotion of second chance.

5.3.3 Costs of second chance measures

Very few estimates of the costs of second chance measures are available. This is mostly due to the fact that second chance measures practically do not exist and if they do their extent and nature vary a lot. For these reasons, it is impossible to compare the costs between countries. In some cases, second chance is understood as in-court re-structuring, which is however out of the scope of this study.

A few examples have been identified to illustrate what kind of measures do exist:

- In Belgium, free coaching on second chance of about eight hours per entrepreneur is available. Between 2010 and 2011 “Tussenstap” Vlaanderen provided this service to 335 entrepreneurs.
- In Germany, the Federal Association of Insolvent Persons and New Chances estimates the costs of one ‘second chance case’ to be around 10,000 EUR with three employees involved, involving full discharge assistance and support during the start of a new company.
- In Luxembourg, they understand the costs of second chance as the process of authorization of the Ministry of Economy and General Prosecution that decides if a failed entrepreneur may start business again. Cost of involvement of five people (of whom one from the Ministry and one from the prosecution) handling one case are estimated at 1,000 EUR.

- In Slovenia, the estimated number of people involved in the ‘compulsory settlement’ is 5-7 external experts, including a financial expert, a lawyer, an auditor, a certified business valuator, a curator and possible other support staff.

5.3.4 Number of companies that have gone through second chance measures

There are hardly any statistics available on how many entrepreneurs have started a new company after their bankruptcy, and the same holds true for the numbers of beneficiaries of support services. It is possible to search data on the numbers of bankrupt entrepreneurs and numbers of new ones, however there is no statistical record on the relation between these figures.

At this stage, some statistics are available only for Belgium. In the period between January 1995 to April 2011, 31,123 Flemish entrepreneurs have gone bankrupt. Of these, 5,631 have restarted and were still active in November 2011. So the percentage of successful re-starters in this period of 16 years for Flanders is about 18 per cent.

In some of the investigated countries, data are available on the willingness and motivation of entrepreneurs to run a business after a previous failure. In Denmark, a survey has shown that approximately 60 per cent of the entrepreneurs that went bankrupt consider starting or have started a new company. In the Netherlands, the number of those who re-started reaches around 10-20 per cent, in Norway it is roughly estimated at 50 per cent.

5.4 Policy recommendations for a smoother second start

Issues to be tackled

Based on the results from the 33 country studies, the most critical issues to be tackled to give honest bankrupt entrepreneurs a good second chance are the following:

- **Distinction between honest and fraudulent bankrupts**
In many countries, bankrupt entrepreneurs are still stigmatised and public does not distinguish between the honest and fraudulent ones. The bad reputation and lack of self-confidence means problems with restarting, or directly discourages *honest bankrupt entrepreneurs* to create a new company.
- **Access to public procurement and support schemes**
In some countries, like Croatia, entrepreneurs cannot participate in public procurement or benefit from grant nor other support schemes after bankruptcy.
- **Quick erasure of negative rating**
The entrepreneurs hardly get rid of the ‘bankruptcy sticker’ as their negative rating remains too long in credit databases. This negatively affects access to finance needed for the new company, and in some case even prevents competition in public procurement.
- **Support schemes tailored to the needs of second starters**
Tailored support programmes do not exist in the majority of countries. It is often mentioned that re-starters can just benefit from the “general” support services for start-ups, although they would need a more tailored treatment and targeted support.

Recommended Solutions

In most of the countries, second chance measures are not a reality as has become obvious from the previous paragraph. We may see some efforts in a few Member States that are aware of the issue and foresee legal changes. However, besides countries such as Belgium, France or Germany, specific measures are largely missing. Possible solutions could be:

- Create awareness raising campaigns that would help to remove stigma of the honest re-starters and increase their self-esteem.
 - In the US, the 1978 Code mandated the deletion of the term “bankrupt” and replaced it with “debtor” to help combat stigma.
- Provide entrepreneurs with clear guidelines explaining the bankruptcy procedures and ways forward after the discharge.
 - Run contact points that are ready to help entrepreneurs in all stages of their business and therefore involve specialized advice also for discharge and second chance.
 - Improve access to consultancy services (e.g. for lower price that would help with regard to discharge proceedings and planning of a new business). Basic information can be provided on a website.
 - The Belgian system of providing free advice could function as a good example.
- Eliminate all measures preventing the second chance starters to access start-up finance or public procurement.
 - In terms of public procurement this would mean that if a clause excluding honest bankrupt entrepreneurs exists in the rules it should be removed. This should be done at Member State level as most procurement laws and guidelines are set at country level.
 - A study could be carried out to identify measures and effects that prevent second chance starters from accessing finance and to recommend adequate solutions.
- Ensure a possibility to get rid of/delete quickly the negative scoring, in the case of honest entrepreneurs.
 - For more information please see Section 6..
- Distinguish between honest and fraudulent behaviour when it comes to bankruptcy procedures, as this is not the case in some of the examined countries.
 - This would firstly include an agreement on a harmonised definition of “fraudulent behaviour” and how countries can make such distinction. For honest bankrupt entrepreneurs, a quicker and simplified procedure could be foreseen.
- Introduce faster and smoother discharge process.
 - The aim is to allow entrepreneurs to deal with bankruptcy in the shortest possible timeframe and save their resources for a possible new business. As much as possible, discharge should be automatic.

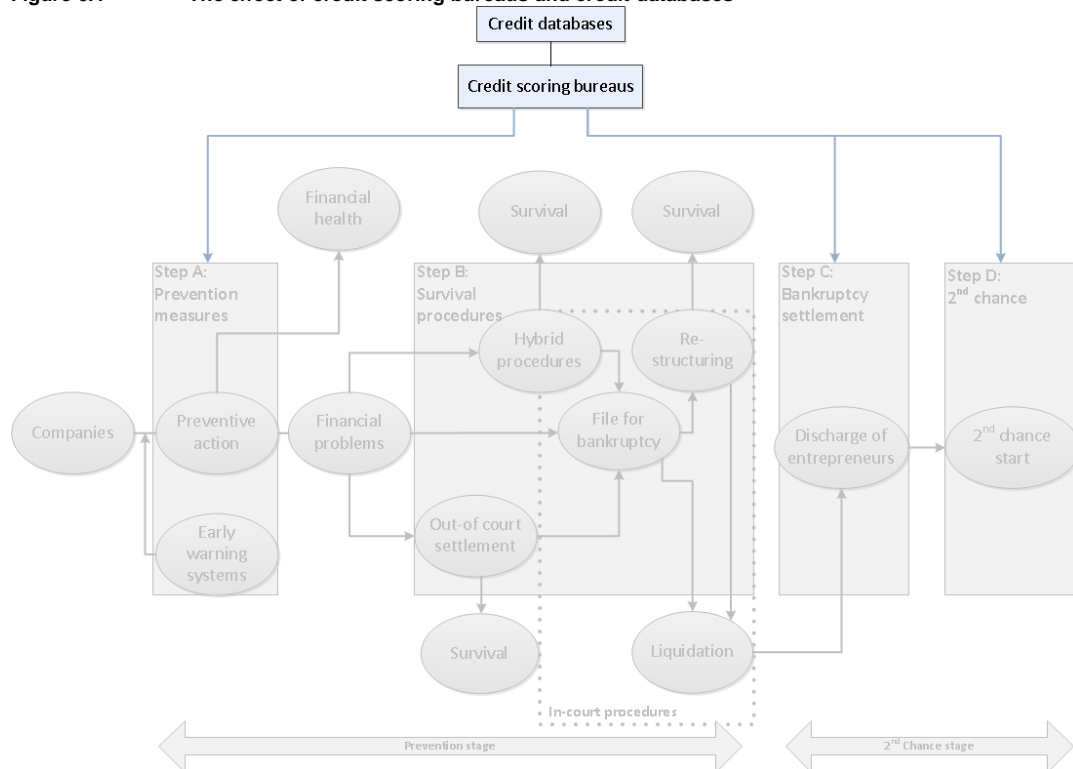
6 Role of Private Credit Scoring Bureaus

6.1 Introduction

Private Credit Scoring Bureaus (PCSBs) play a significant role in both the prevention stage (by for example providing early warning systems) as well as later in the second chance stage (by deleting information and creating fresh credit scores). Also Credit Databases (CDs) that feed the PCSBs with information have a crucial role in both of the processes.

Figure 6.1 below illustrates the points of the bankruptcy process where PCSBs and CDs have a significant effect and are therefore relevant for this study.

Figure 6.1 The effect of credit scoring bureaus and credit databases



Source: Ecorys

In Section 0 we present the environment and the functionality of both PCSBs and CDs to set the right context before moving to the analysis of main findings in Section 6.3. We finish the chapter with policy recommendations based on our analysis in Section 6.4.

6.1.1 Difference between credit rating and credit scoring

Private credit rating agencies are required to register with ESMA and the public ratings they issue, must be issued in accordance with Regulation (EC) No 1060/2009 on credit rating agencies.. In general credit ratings are assigned to debt issues, equity issues and structured products, be it corporate, or sovereign. In effect, ratings give an indication of the risk level of a(n) (often) complex financial instrument that allows investors to make better and more informed decisions.

As of May 2014 there are 23 registered and two certified CRAs in the EU. Amongst the 23 registered CRAs, three operate under a group structure, totaling 16 legal entities in the EU, which means that the total number of CRA entities registered in the EU is now 36 (ESMA⁷³).

The sector is rather consolidated with the big three players (Moody's, S&P and Fitch) accounting for around 90% of the market in the EU. However, there is an increasing number of CRAs that focus in particular on the corporate financial side and in particular on the mid-sized companies (around 200 employees and an issue of EUR 5m – EUR 10m). In this sub-sector the big three together account for about half of the market share and it is here that the majority of the other CRAs operate.

When a company is declared insolvent, the credit rating is usually put on pause, or in other words “frozen” and in case of a restart (and a new issue), or the entrepreneur's new company conducting an issue, a new credit rating analysis is carried out and a new credit rating given. This is largely due to the fact that a credit rating is conducted based on a specific issue, or a product and therefore each time a new rating has to be made.

Part of the analysis of CRAs includes an examination of the management of the company. If for instance the CEO was previously in charge of a company that went bankrupt, such information is considered when his current company wants to issue a large bond issue. Yet there are much more significant factors that are analysed (such as financial health of the company, future outlook, cash flow issues, etc.). In effect, this means, that although the past performance of management is significant and taken into consideration, it is not instrumental to the rating, thus allowing for a substantial “fresh start”. If, therefore, a restart of a company occurs, a new credit rating is conducted. This is because the restarted company is in a completely new situation after coming out of insolvency proceedings and therefore so are the conditions for the rated issue or product.

The nature of the focus of credit ratings therefore permits a restart and second chance for large companies. Furthermore, given that the industry is already regulated (most recently in July 2013 by a new regulation on CRAs⁷⁴: EC, IP/13/555) and closely monitored by ESMA, there seems little scope for further EU involvement, beyond the current set up.⁷⁵

A distinction should be made between the activities conducted by credit rating agencies and credit scoring bureaus. Both activities are sometimes referred to as credit rating and some companies engage in both rating and scoring, however, credit rating and credit scoring are two distinct activities, as defined in law⁷⁶, and credit rating is a regulated activity across the EU.

⁷³ <http://www.esma.europa.eu/news/ESMA-approves-EuroRating-credit-rating-agency?t=326&o=home>

⁷⁴ Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies, OJ L 146, 31.5.2013

⁷⁵ Based on the analysis conducted, interviews and in-depth discussion with experts.

⁷⁶ Definitions of both can be found in Article 3 of Regulation (EC) No 1060/2009 on credit rating agencies, as last amended by Regulation (EC) No 462/2013.

Private Credit Scoring Bureaus (PCSB) are also sometimes referred to as “credit information agency” or “credit reference agencies”. These are private non-financial⁷⁷ companies that provide a customer with an analysis of the creditworthiness of a company, entrepreneur or sector (as opposed to CRAs that mainly rate individual issues and financial products⁷⁸). Credit scores are mainly conducted through standardised quantitative models (to allow for economies of scale) and usually try to cover the entire spectrum of companies in an economy.

By moving towards statistical models, credit scoring can be more objective. This is due to the fact that credit scoring models consider the characteristics of good as well as bad payers from a large sample considering indicators that have a significant correlation with repayment performance. While judgemental (subjective) methods are generally biased towards awareness of bad payers only and rely on an individual’s memory and experience (Abdou and Pointon, 2011).

The heavy reliance on quantitative models also means that credit scores are dependent on the information that is provided to and used by the model as well as the way that the model is constructed. This means that credit scoring models are susceptible to a ‘misclassification problem’ (Abdou and Pointon, 2011). This occurs when the company is not analysed correctly either due to a rigid analytical framework that is incapable to adapt to individual circumstances, or that the data that is used is insufficient, or incorrectly weighted.

Nevertheless empirical evidence shows that the introduction of the Small Business Credit Scoring Model has expanded the access to finance, especially to small and/or “marginal borrowers” that would otherwise not have received credit. (Berger, Frame and Miller, 2002; Frame, Srinivasan, and Woosley, 2001). This is largely due to correct pricing and understanding of the underlying risks.

Lastly, unlike CRAs that are fully regulated and supervised at the EU level and have to comply with high standards on transparency, methodologies and measures to address conflicts of interests, PCSBs fall outside the scope of EU regulation.

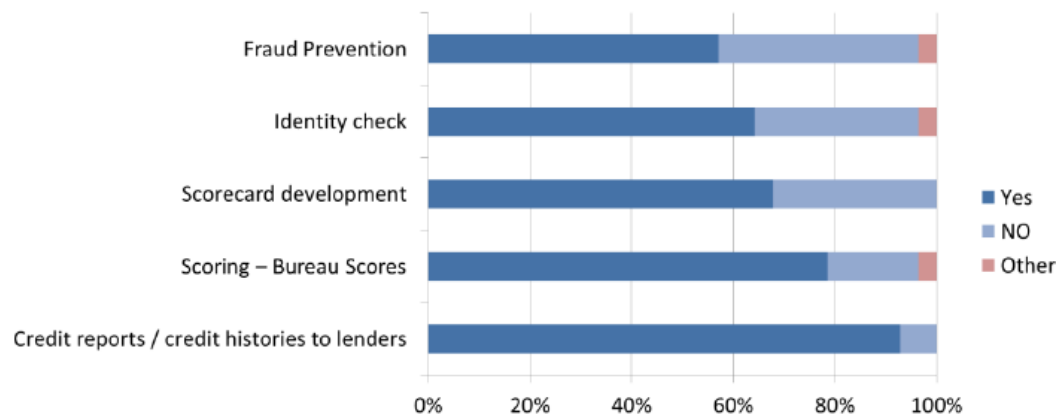
It is due to the importance of PCSBs to the economy, their crucial effect on the success of a preventive and second chance process, while remaining susceptible to errors, that *PCSBs (and credit databases that supply their data) are the subject of this study* instead of CRAs.

⁷⁷ Since the Basel III rules oblige banks and other credit allocating financial companies to conduct their risk and credit scoring analysis in house, rather than relying on contractors.

⁷⁸ This means that although companies are also analysed they are done for the purpose of the issue at a given time. Therefore the issue is the main focus of the rating, rather than the company itself (although that is an important indicator). Furthermore given that issues are usually done by large enterprises, ratings do not usually cover small companies or entrepreneurs.

A 2012 ACCIS survey asked 28 credit bureaus in 21 different countries (all their members) to specifically identify the type of services that they provide, see Figure 6.3.

Figure 6.3 What credit services and products does your company provide?



Source : ACCIs 2013 study on credit bureaus in Europe

Assessment criteria

Each credit scoring company has a different credit scoring model and procedures that are particular for that institution and are tailored to the corporate strategy of the company. This means that these are tailored to what the management of the PCSB considers as appropriate. These models are constantly being developed in the light of new findings.

There are eight main areas when it comes to analysing the creditworthiness of a company, or in other words its credit score⁸¹:

- Solvency;
- Working capital;
- Liquidity;
- Profitability;
- Growth;
- Debt;
- Cash-flow;
- Client relationship.

From the country studies we have been able to identify the following additional indicators that are commonly used:

- Credit repayment history (information gathered from suppliers, banks or credit databases);
- Litigation, bankruptcies or other legal procedures (information gathered from courts or credit databases);
- Macro-economic situation (modelling the economic development and sector realities);
- Operational performance (market share, product mix, capacity);
- Management (often through previous encounters, reputation and newspapers);
- Company structure (subsidiaries, corporate governance).

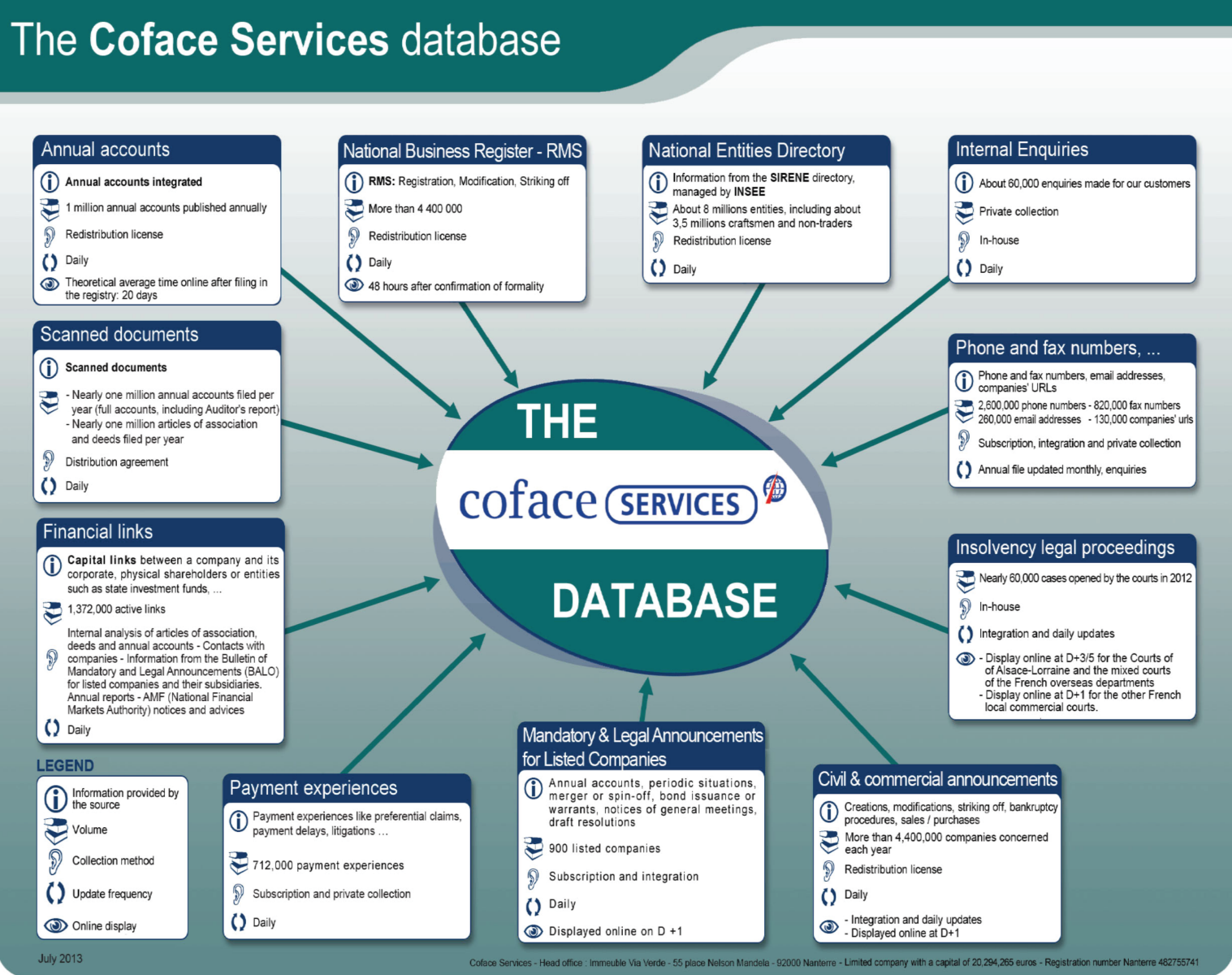
⁸¹ From the script material used at a course of “Certified Expert in SME finance” at the Frankfurt Business School, winter 2014.

A credit score is constantly updated as the company is monitored. Therefore, if a company's financial health worsens, this will be directly translated into a lower credit score. The effect depends on the severity of the problems, but most credit scoring models have a mechanism to distinguish between such severity levels and incorporate them proportionally in the overall model.⁸²

The information is usually collected through various sources (in Belgium one PCSB has over 60 different sources), but often also by using credit databases (see next section). As an example of the complex nature of the different type of information we give an example from one Coface Services (now renamed Ellisphere) in France, see Figure 6.4 below. The reason why we have included this particular example is that France does not allow CDs to be used by commercial companies and therefore Ellisphere has had to conduct the whole data collections on its own, giving the best idea on the type of information that a PCSB focused on SMEs needs.

⁸² Based on expert conversations.

Figure 6.4 Type of data used for credit scores

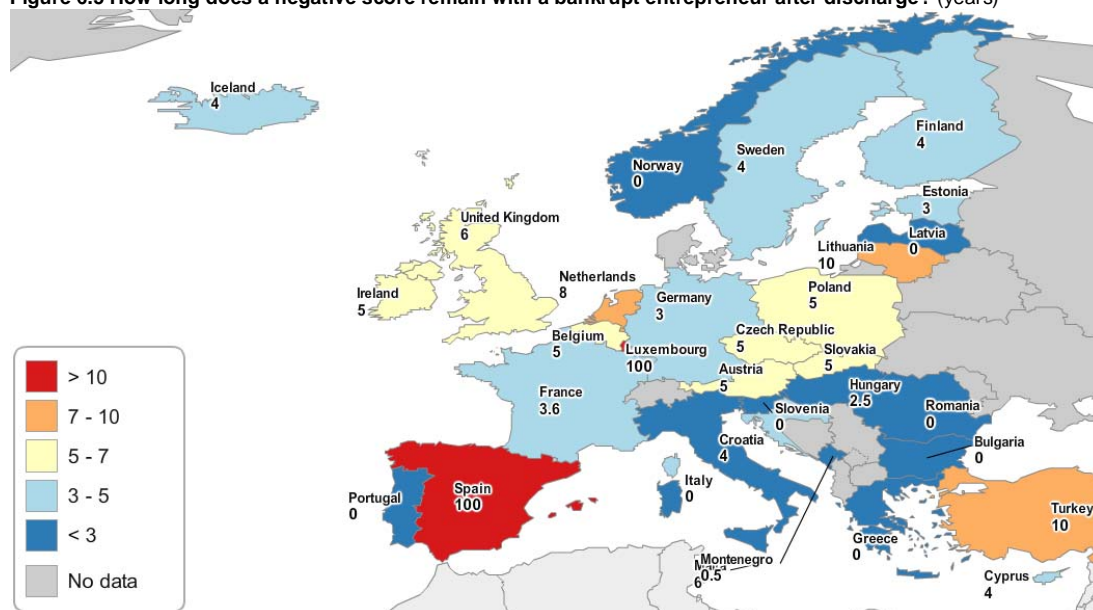


Upon the termination of bankruptcy and the passing of discharge time, the theory is that the credit scoring of the company is deleted and a new credit scoring analysis is conducted. This will be done completely independently of the past performance of the company.

However, in practice we have found that although this might be true for a company (especially when it restarts under a different name), this not to be the case for the individual entrepreneur, where as an individual he carries a negative score for some time after the end of a bankruptcy, or litigation procedure.

Figure 6.5 shows for how long a bankrupt entrepreneur remains with a negative score. In nine countries this does not happen and the entrepreneur's negative score is deleted immediately. Yet in most of the countries the time differs, with Spain and Luxemburg never deleting the score.

Figure 6.5 How long does a negative score remain with a bankrupt entrepreneur after discharge? (years)



Regulation

Besides the EU's Data Protection Directive (Directive 95/46/EC), there is no harmonised regulation that applies to PCSBs. Having said that, there are six countries that have additional regulations and systems that are already in place for PCSBs (in green and labelled as 2 in Figure 6.6 below), while most countries have additional privacy protection rules that effect the operations of PCSBs (in blue and labelled as 1 in the map below).

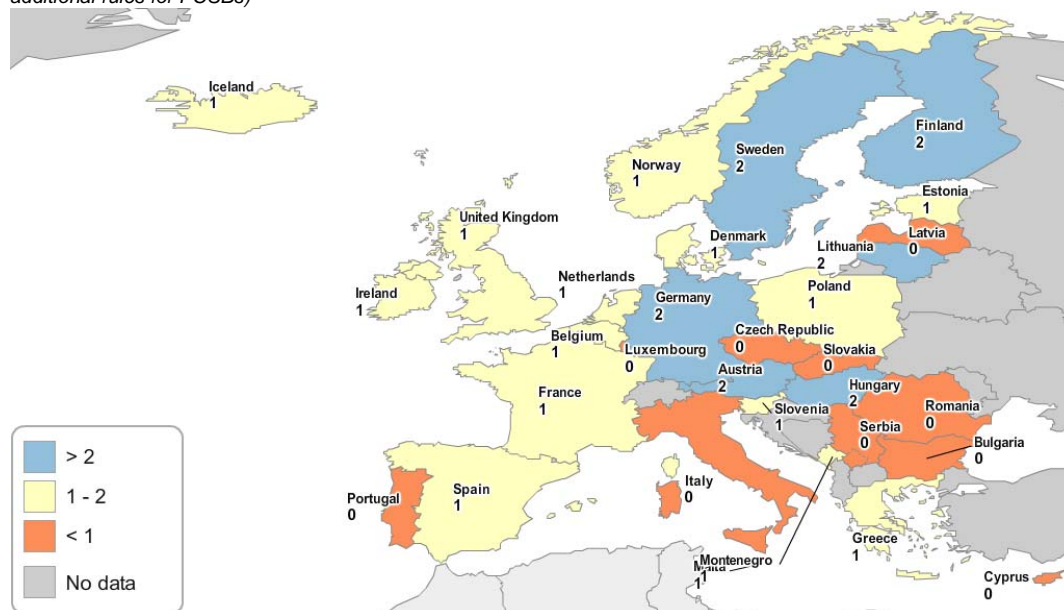
Box 6.1 Regulation of scoring bureaus in the US

According to a US law if an individual or a company has good grounds that a credit score is incorrect he/she can ask for a new one to be made. However, the old one does not get deleted and therefore the information, even though it was proven to be false remains.

Recently a new agency was established to look at financial practices of providers and to seek to regulate unwanted excesses (in the similar way that the FCA in the UK was established). The new agency (Consumer Financial Protection Bureau) will also seek to regulate PCSBs.

Figure 6.6 Are PCSB regulated?

(0 orange = no; 1 yellow = privacy protection rules besides EU ones; 2 blue = privacy protection rules + additional rules for PCSBs)



From the country studies we have been able to identify the following regulatory frameworks that focus additionally on PCSBs:

- Austria – PCSB are regulated according to § 152 of the Austrian trade regulations.
- Finland – The Data Protection Ombudsman has to give permission before a company can engage in credit data activity. The Data Protection Ombudsman also has a supervising role. At the time being, only 4 companies have been authorized to engage in credit data activity.
- Germany – credit bureaus are regulated in Germany, for example through the German Data Protection Act (BDSG), banking law (e.g. German Banking Act (KWG)), German Remote Sales Act (FernAbsG) and the Consumer Protection Act.
- Lithuania – There are additional laws on “State Information Resources Management” as well as “Legal provisions regulating the use of various state registries”.
- Sweden – The operation of PCSB in Sweden requires a permit from the Data Inspection Board, which is the regulatory and supervisory for PCSBs in Sweden. The Data Inspection Board exercises supervision over compliance with respect to the applicable framework, including the Credit Information Act. The Data Inspection Board publishes a list of authorized credit scoring companies.
- Hungary – The activities related to company information are regulated by several legislations, but there is no law directly focussed on company information services. The connected legislations that control company information services are the following: the Act LXIII. of 1992. on data protection, the Act IV of 2006 on Business Associations (after 15. 03. 2014 the New Civil Code), Act XLIX. of 1991. on bankruptcy and Liquidation, 47/2007.(X.20.) Decree of the Ministry of Justice on the free company information, the Act CXLV. of 1997. on company registration and company information, the Act V. of 2006. on company information, company registration and winding procedure, and the Civil Code.

6.2.2 Credit Databases (CDs)

Specialised companies and/or public bodies collect the vast amount of information available on a company/entrepreneur, format it and present it in the form of Credit Databases. Such information will include the credit repayment histories of companies/entrepreneurs, financial data, bankruptcy procedure outcomes as well as a variety of other data. But unlike PCSBs they do not process the information further.

The availability of these databases to private companies, such as PCSBs, differs between the different countries. In three of them they do not exist at all. Italy and the Netherlands have consciously decided and legislated against having them. In one in five countries the databases exist, but are not available to private companies. However, half of the countries⁸³ have both these databases and they are available to private companies, most often for a licencing fee.

Many of the PCSB companies also have a CD branch (see Annex III for a list of those that do). This allows them to create in-house databases to later use for credit scoring and/or sell the data to others creating an additional revenue stream.

Box 6.2 The use of credit information in the US

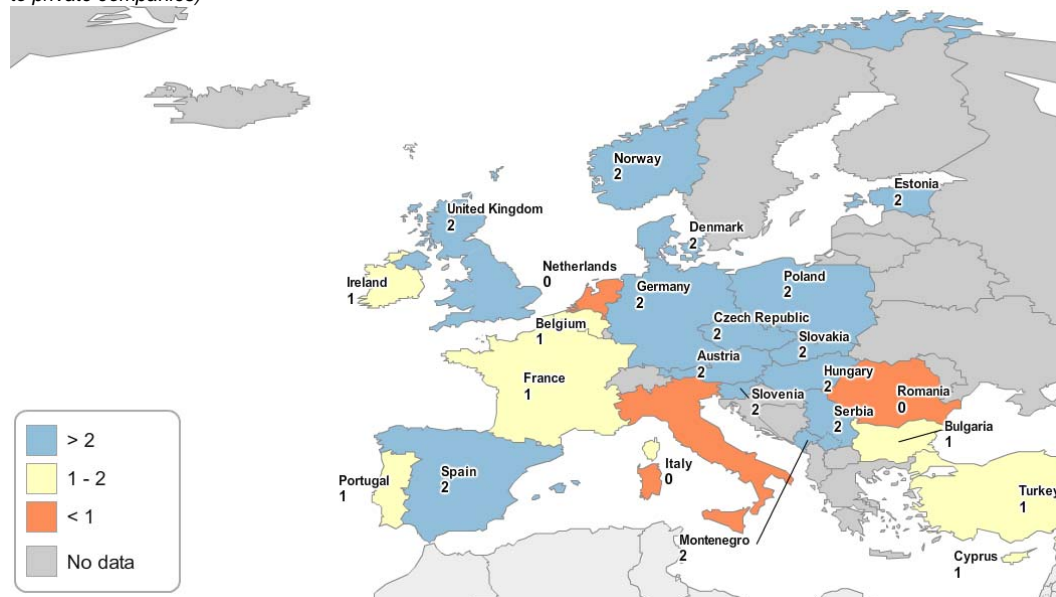
In the US each individual, entrepreneur and business has the right to ask PCSBs for his/her score once a year. But paradoxically the act of asking can have a negative impact on the future score.

Over the past several years there has been a growing over-reliance on credit information in different walks of life. For example some car insurance companies in the US have been using credit information and scores to determine the cost of insurance and in some extreme examples employment was also subject to a review of credit history. Legislators are beginning to push back and for example this year the state of Michigan passed legislation limiting the use of credit scores and credit information in several fields.

⁸³ With available data for this study.

Figure 6.7 Do credit databases exist?

(0 orange = no; 1 yellow = yes, but are not accessible to private companies; 2 blue, yes and they are accessible to private companies)



The information collected

The breadth and depth of credit information varies significantly between European countries, but as a general indication they include (DG Market, 2009):

- Status information on the individual/enterprise (legal status, corporate governance, public registry, etc.);
- Financial data;
- Repayment history of the individual/enterprise;
- Public data (court judgements, restructuring arrangements etc.);
- Other relevant information.

A 2012 ACCIS⁸⁴ survey asked 28 credit bureaus in 21 different countries (all their members) to specifically identify the type of information that they collect, see Figure 6.8 below.

⁸⁴ Association of Consumer Credit Information Suppliers

Figure 6.8 What type of data do you collect?

What kind of data do you collect		AT	BE	CH	CY	CZ	DE	DE	DE	DK	ES	EL	HR	HU	IT	IT	NL	NL	NO	PL	PL	RS	RO	SE	SK	SL	UK	UK	UK
Yes	No	KSV	NBB	CRIF	Artemis	CCB	Schufa	Boniversum	ICD	Experian	Experian	Tiesias	HROK	BISZ	Experian	CRIF	Experian	BKR	Experian	KRD	BIK	Serbia	BDC	UC AB	SCB	Sisbon	Callcredit	Equifax	Experian
Income																													
Assets e.g. shares, property, savings																													
Limit																													
Original amount of credit																													
Outstanding amount																													
Interest rate or information that rate is preferential																													
Payment terms or periodicity of repayment																													
Duration of loan e.g. start & end date																													
On-time payments																													
Presence on rejected cheque list or status code to show cheque or payment returned																													
Missed payments																													
Do you hold information on the number of days loan is past due in addition to a missed payment																													
Do you show data on accounts that are settled - Fully paid																													
Partially paid and no further funds expected																													
Written off/default																													
Do you hold data on special payment terms for accounts in difficulty?																													
Bankruptcy/insolvency data																													
Court judgements																													
Notes CZ - Interest rate can be partially calculated from instalment data																													
Special payment terms for some accounts from our debt collection partners																													
Special payment terms : Suspension of payment for SMEs																													
Suspension of mortgage instalments for family																													
Suspension of payment for people living in the earthquakes- affected areas																													
Yes, indication for the start of re-financing plan																													
Voluntary terminations on car loans, deceased																													

Source : ACCIs 2013 study on credit bureaus in Europe

Where this data comes from also very much depends on the country, see Figure 6.9 below.

Figure 6.9 What type of organisation supplies data by country

What type of organisation supplies data to your credit bureau?	AT	BE	CH	CY	CZ	DE	DE	DE	DK	ES	EL	HR	HU	IT	IT	NL	NL	NO	PL	PL	RO	RS	SE	SK	SL	UK	UK	UK	
	KSV	NBB	CRIF	Artemis	CCB	Schufa	Boniversum	ICD	Experian	Experian	Tiesias	HROK	BISZ	Experian	CRIF	Experian	BKR	Experian	KRD	BIK	BDC	Serbia	UC AB	SCB	Sisbon	Callcredit	Equifax	Experian	
Banks																													
Public quoted																													
Private																													
Post banks																													
Cooperative banks/ building society																													
Other (please describe)																													
Credit unions																													
Debt collectors / debt purchasers																													
Leasing																													
Credit card suppliers																													
Retail credit suppliers																													
Insurance companies																													
Utilities – electricity, gas, other fuel																													
Utilities – water																													
Telecommunication companies (mobile phones, land phones)																													
Television supplier (cable TV, satellite TV)																													
Internet provider (broadband)																													
Mortgage providers																													
Brokers/Intermediaries																													
Courts																													
Government departments																													
Tax authorities																													
Others (please describe)																													
Mail Order Dentist Association																													
Public sources, e.g. official bulletins																													
Factoring and Credit provision companies which hold operation license																													
Consumer Finance companies or Financial Institution																													
Motor finance																													
Chambers of commerce.																													
information about current debts																													
State owned funds granting a loan																													
Peer to peer lenders																													
Covered																													
Not Covered																													
No organisations in this country																													

Source : ACCIs 2013 study on credit bureaus in Europe

The type of borrower that the above mentioned information is being collected on varies significantly depending on the country.⁸⁵ On average the information is for individuals more readily available than for businesses and entrepreneurs.

Figure 6.10 Categories of borrowers that data is being collected on

On which categories of borrower does your organisation collect data from lenders?	AT	BE	CH	CY	CZ	DE	DK	ES	EL	HR	HU	IT	NL	NO	PL	RS	RO	SE	SK	SL	UK
Up to date																					
Individuals	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Sole Traders	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
SMEs	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Businesses of any structure	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Other groups	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
In arrears																					
Individuals	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Sole Traders	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
SMEs	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Businesses of any structure	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Other groups	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
In default																					
Individuals	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Sole Traders	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
SMEs	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Businesses of any structure	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Other groups	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Any legal entity of any other form (associations, municipalities, etc)	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Yes

No

Source : ACCIs 2013 study on credit bureaus in Europe

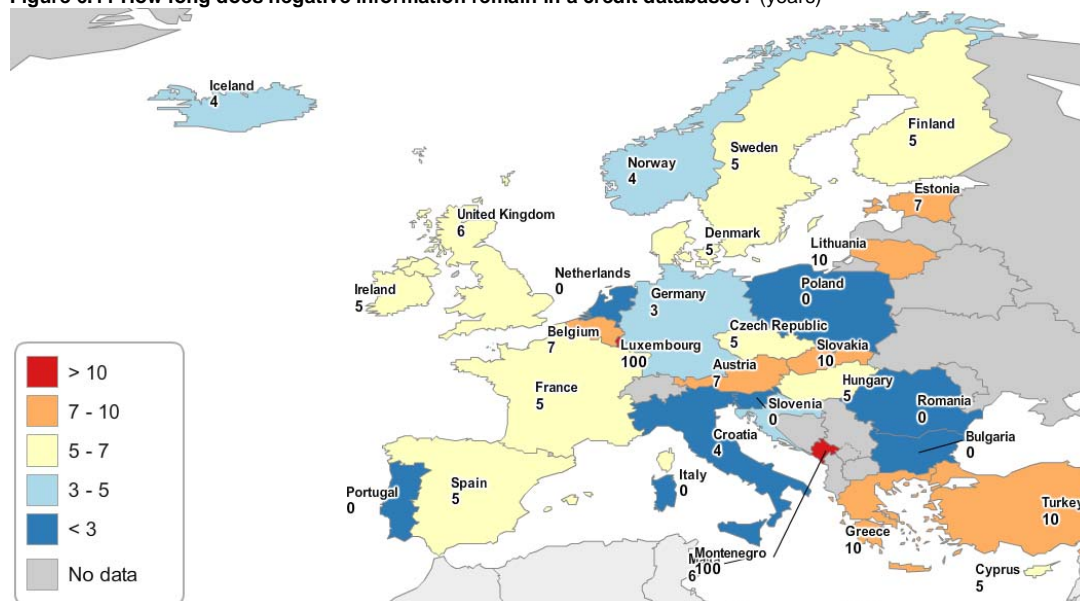
Length of keeping information

All this information that is collected by the CD is stored at the company. This includes all the financial information as well as the positive and negative information⁸⁶. This information (in particular the negative information) heavily influences the credit score and therefore the length for which it is available will influence the success or failure of both prevention and second chance.

⁸⁵ This is not to say that other information is not being collected from other non lender sources.

⁸⁶ Negative information includes for instance evidence of default, insolvency data, court judgments etc.

Figure 6.11 How long does negative information remain in a credit databases? (years)



6.3 Analysis and key findings

We have conducted a thorough analysis of the available data both quantitative as well as the qualitative from country experts and the specific survey and have concluded the main following findings.

PCSBs have a positive impact

Scoring is much needed to deal with the information asymmetry between the company/entrepreneur and a counterpart. Directors have an informational advantage over lenders/investors because they know more about the health of their own company. However, for individuals and to a certain extent entrepreneurs the opposite applies, where the entrepreneur is likely to have an 'optimism bias' towards his own activity and future outlook, as opposed to the lender/investor, who perhaps has more experience in the sector and overall trends.

This informational advantage results in adverse selection (the classic "lemons" problem mentioned by Akerlof, 1970) that occurs because lenders/investors cannot differentiate "good" companies or entrepreneurs (low default risk) from "bad" ones (high default risk). In this way, average risk will be taken into account, resulting in for instance restricted access to credit, a premium to be paid for their credit or other disadvantages with respect to their relationship with investors even for economically healthy companies/entrepreneurs (Dinh, Kleimeier and Straetmans 2011).

As mentioned earlier (section 5.1), the introduction of scoring models has been proven to have expanded the access to finance especially for small and/or "marginal borrowers" that would otherwise not have received credit (Berger, Frame and Miller, 2002; Frame, Srinivasan, and Woosley, 2001). The study attributes this largely to correct risk pricing as described above.

Other research shows that the good use of a strong credit scoring model demonstratively creates a more stable environment, where lenders are more frequently repaid and therefore themselves do not get into financial trouble (Blochlinger and Leippold, 2005). In fact, the lender can expect an 8.4% increase in its SME portfolio performance as information costs are lowered and better lending decisions are made (Frame, Srinivasan, Woosley, 2001). Furthermore, the economy as a whole

also greatly benefits since greater stability is achieved, which in turn is a key driving force behind investment and sustainable growth.

In Europe such benefits are largely reeled in by banks, that provide 85% of all non-financial corporate debt, compared to the US where this is only 53% (EC SWD, 2013). It is suggested that the main reasons behind this overreliance on bank loans, especially when it comes to SMEs, is the difference in: (a) the disclosure culture, (b) the availability of information and (c) the practices during the analysis (EC SWD, 2013).

PCSBs have an important role to play in prevention process

In the introduction to this chapter as well as the description of the bankruptcy process (section 2.2) we have shown that PCSBs have an impact on the prevention process. We have come to this conclusion based on three facts:

- When looking at the type of information that is being collected (5.2.2) and the assessment criteria that are being used (5.2.1) it is evident that these are *the most relevant indicators available to warn of upcoming financial problems and changes in relative timely fashion*. The fact that they are conveniently compiled into one place makes CDs and therefore PCSBs best placed to access information for analysing firms in the most up to date nature.
- *PCSBs have statistically accurate models to analyse the health of companies and entrepreneurs*. In this way they have had the time to further develop the models that can best use the latest data and analyse the kind of effect that it would have on the financial health of companies and entrepreneurs.
- Several of our respondents have confirmed that *informing clients and businesses themselves of upcoming financial issues is one PCSB's main commercial products*. This means that there is already an industry that exists and focuses on providing early warnings to paying clients

Therefore **PCSBs are perfectly placed to be used as early warning systems** and in some cases this already takes place.

Box 6.3 Ellisphere's "transparency chart"

Ellisphere's "transparency chart"

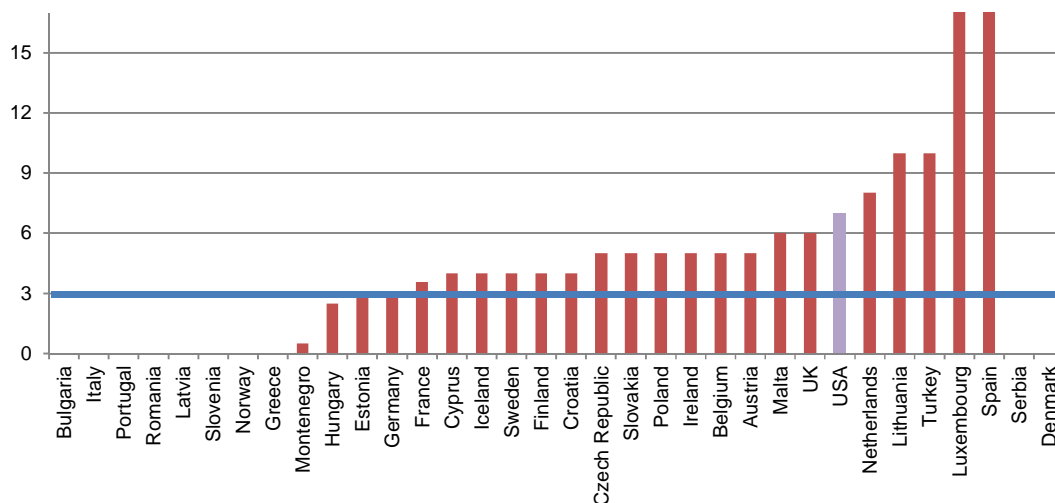
In exchange for a company voluntarily giving Ellisphere their information, Ellisphere gives the enterprise/ entrepreneur his/her own scoring. The initiative has been in operation for 4-5 years and also works to explain the benefit and value of credit scoring for companies. In this way each year around 10 000 companies are contacted. The companies can then subscribe for ongoing monitoring and/or financial advice how to deal with the issues.

CDs and PCSBs have significant impact on the success of second chance

One requirement to a successful second chance is the ability not to be negatively impacted by past events, including bankruptcy. The idea behind this was to limit a negative score to a discharge time of 3 years after the completion of bankruptcy (see Chapter 4).

However in practice the length that information stays with an entrepreneur is longer in many countries. In fact *in only 43% of the countries studies did the PCSBs delete the entrepreneurs negative scoring in 3 years or less*.

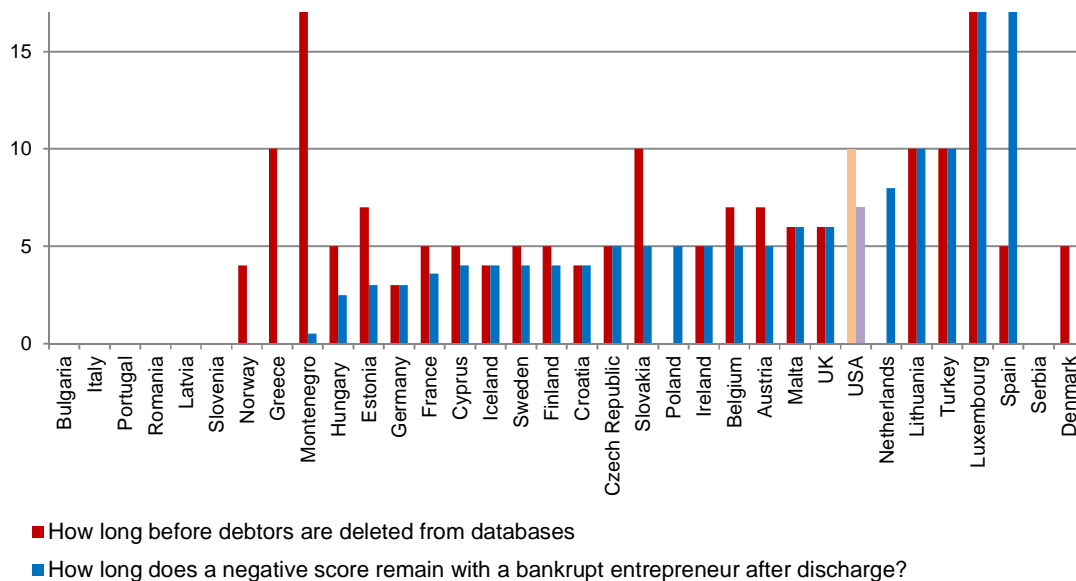
Figure 6.12 How long does a negative scoring remain with an entrepreneur



One of the striking differences that we have found was that in one in three countries the time for a debtor to be deleted from a database is longer than the time that a negative score persists with a bankrupt entrepreneur. The only difference is in Spain and Netherlands (where in NL there are no databases). For comparison we show that a similar situation is in the US, where the information rests in databases for up to 10 years, while scoring is deleted within 7 years.

In this way, those 12 countries have a system, where although the negative scoring of an entrepreneur no longer applies the negative information on him/her is still accessible. As such the PCSB model will not automatically take it into account, but closer analysis of information available in CDs (for instance based on a specific request) will mean that the information can surface and undermine a successful second chance.

Figure 6.13 Difference between discharge time from databases and scores



This means that in several countries a successful second chance for an honest entrepreneur could be greatly hindered by the existence of negative scorings on an entrepreneur mainly caused by

simply the available data. This is largely due to the fact that the credit scoring models will calculate the information that is fed into them, or actively “frozen” such as occurs in France for example.

Box 6.4 Internal databases of PCSBs

In the above, by databases it is mainly understood as those that can be accessed, licenced, sold or bought. What is not mentioned is the internal databases held by PCSBs, banks and all other institutions. Here we have found¹ that in the databases that are internally kept, the negative information on an entrepreneur is sometimes never deleted. Although it might not be used during the credit scoring procedure after a certain time, the information remains. This practice has been ruled as illegal by the recent European Court of Justice’s decision on “the right to be forgotten”, the effect of which is still to be seen.

For the honest entrepreneur the outcome is that although in many countries he/she should be able to start again, there will still be kept data about him/her that will link him/her to his/her past bankruptcy and therefore could seriously harm his/her restart options, in terms of dealings with suppliers or access to finance.

On the other hand it is also important for investors/creditors to have the data available to deal with information asymmetry and be able to make the most informed decisions. *This fundamental tension remains unresolved* and rules / regulations will most likely rest upon a political choice based on values: the right to be forgotten *versus* comprehensive information.

From our discussions with the PCSBs and their analysts we have gathered the impression that indeed there are different approaches already in place where *some countries view the first few bankruptcies of an entrepreneur less negatively compared to others*. This is evident in their approach of setting up their credit scoring models where some put previous bankruptcy as a negative indicator, while others do not consider it (if the entrepreneur operates under a different company name and has not had several bankruptcies). The countries that identified such difference are:

- Austria, Germany, Malta, UK: previous bankruptcy is not considered for a new credit score after a restart.
- Belgium, France, the Netherlands: previous bankruptcy negatively effects the new credit score after a restart.

PCSBs have two inherent weaknesses

The importance and reliance on PCSBs means that inherent weaknesses and risks should be addressed. The weaknesses lie in the credit scoring model and the data feeding the model.

The credit score is only as strong and accurate as is the credit scoring model. This means that if the model has biases, misclassification problem or errors it will affect all the outcomes and validity of findings.

PCSBs spend a lot of energy and research on developing such models, based on expert involvement and rather global standards published by the World Bank in their 2011 “General Principles for Credit Reporting”⁸⁷. To the best of our knowledge, there are no other industry standards, nor common practices of peer testing/scrutiny. Under the old ECAI system there existed a framework of accreditation of the model and the company with strict procedural steps and continuous oversight by a national regulator, (see Box 6.5 below for more information).

⁸⁷ http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/Credit_Reporting_text.pdf

Box 6.5 Accreditation process of External Credit Assessment Institutions (ECAIs)

Past accreditation of ECAIs*

The accreditation process is conducted and supervised by a national legislator/agency in each of the Member States, however 'minimal standards' were set by EC/1060/2009. These set the following criteria for the accreditation process:

- **Objectivity** - the authorities had to verify that the methodology is rigorous, systematic and historically accurate. This included testing of the credit scoring models to ensure that they worked accurately.
- **Independence** – the authorities had to verify that the methodology is free from external political influences or economic pressures that could affect the outcome. This involved a close scrutiny of the PCSB's structure and corporate governance.
- **On-going review** – the authorities had to ensure that internal systems are in place within the PCSB to review its methodology to ensure that it is working correctly, with audits and checks being occasionally performed by the authorities.
- **Credibility and market acceptance** – the authorities had to check if the credit assessments produced by the PCSBs were accepted in the market and regarded as credible. This was designed to ensure that not only was the methodology sounds, but also its outputs.
- **Transparency and disclosure** – the authorities had to ensure that credit scores that were designed to be public were available to every interested party, thus creating a playing field for the users of the credit information.

*) The Credit Requirement Regulation, of July 2013, harmonised the definitions of ECAI to only include credit rating agencies, which are registered, authorised and supervised by ESMA. In addition, in accordance with Basel III rules (that were also implemented in this Regulation) PCSBs could no longer be outsourced by banks as the sole risk assessment tools, implying rather that financial institutions develop their own internal procedures, models and departments.

The other problematic and risk-fraught area is the data feeding the model. This can be broken down further into two main issues, namely the availability of data and the quality of data.

The availability of data

In general models are only as good as the data that gets feed into them. Even the best designed and well-tested models can fail to work properly, or give biased results if information provided is simply not available, or is too patchy. In this sense to have accurate, real time (without a time lag) and complete data is key to a successful model.

From our interviews and specific survey we have found that the level of available information that is available to PCBRs is far from easily accessible in all countries. Below are two examples that describe the different accessibility of data and the difficulties in obtaining them:

In general *France has a very good system of available information* on companies, enabled by licencing fees charged by public bodies to private companies for access to its databases. However, CDs are not accessible to commercial companies such as PCSBs meaning that the information has to be collected with great difficulty and often by using proxy indicators, rather than the actual data.

On the contrary in *Spain and Portugal information is very difficult to attain* (often available only at regional or even sub-regional sources), it is therefore expensive and at times not even in digital format (but rather a printed sheet on a notice board). This makes data collection extremely costly and time consuming, which results in significant time lags to the data.

The issue that we have heard being mentioned most prominently was *the availability of information on micro enterprises and entrepreneurs*, in that it is a major obstacle in conducting/calculating accurate scores. The respondents have stated that this problem has been aggravated by recent regulation. Company Law Directives, in particular the 2013/34 directive regarding annual accounts, enable Member States to allow micro-entities not to publish their accounts anymore and reduce the amount of information to be filed by small companies.

Although the aim towards reducing administrative burden for micro-entities is understandable, the effect of limited available information means that credit scores are very difficult (and costly) to be conducted for micro-entities. *This has the effect that often they are not covered by the existing models*, which in turn can have significant negative consequences for the micro-entities themselves and their access to finance.

The quality of available data

The quality of the data that is available is also important, since if empty or misleading data is the only one present the outcomes of the model would be seriously affected. The example in the following box demonstrates that.

Box 6.6 “Disappearing” companies in Spain and USA

“Disappearing” companies in Spain and USA

In Spain in 2013 there were only 900 bankruptcies recorded, which is a fraction of the reality, while in the US the ratio is even larger. The common practice is to simply come to an informal agreement with the creditors & then to wind down and close the company. This way procedural as well as reputational costs are minimised. In this way thousands of companies simply “disappear” each year.

Informa (PCSB in Spain) has developed a system to find such “disappearances” and label them in their database as essentially bankrupt.

However, the quality and relevance of the data that is reported about the entrepreneur and then saved by the CDs is also crucial. As demonstrated earlier in this report, the time that negative information is held on an entrepreneur varies quite significantly. Given the length of practical discharge in some countries an entrepreneur could (and some of them do⁸⁸) argue that *some of the information available is no longer relevant and should not be considered as input of good quality into credit scores*. Although such abbreviated statements are based on qualitative research such issues should be carefully considered, or individually researched.

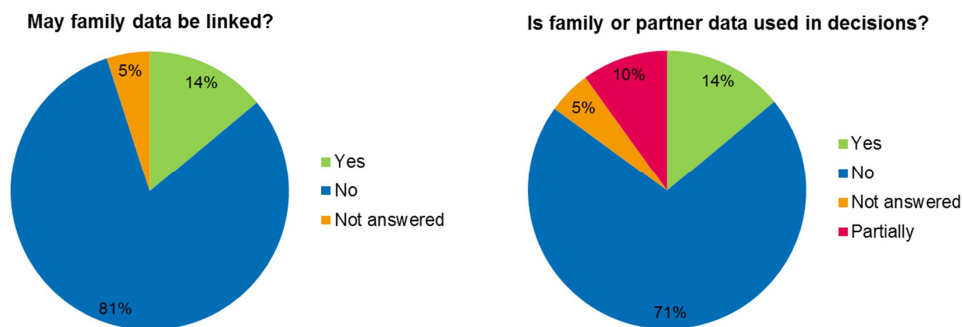
The other issue of quality of available data touches upon sensitive, personal privacy issues and where the line should be drawn on what is relevant in the public interest and what is invasion of privacy. The guiding principle in this debate is the overarching data protection given by the EU's Data Protection Directive (Directive 95/46/EC) (for more information on this directive please see 2.3.2). *This directive is currently being updated and therefore its implications should be considered once it is approved. Another important legal norm for PCSBs and CDs has been set by the recent European Court of Justice's decision on “the right to be forgotten”⁸⁹.*

⁸⁸ Based on the feedback that we have received during our study

⁸⁹ <http://curia.europa.eu/jcms/upload/docs/application/pdf/2014-05/cp140070en.pdf>

The fact that sometimes private data is indeed collected (highlighting the seriousness of the issue) was illustrated in a survey conducted by ACCIS⁹⁰ in 2012. In that survey they asked their members (all PCSBs and CDs) two specific questions that demonstrate the seriousness of such debate and that harmonisation is far from achieved, see Figure 6.14 below.

Figure 6.14 Is sensitive personal data being collected and used.



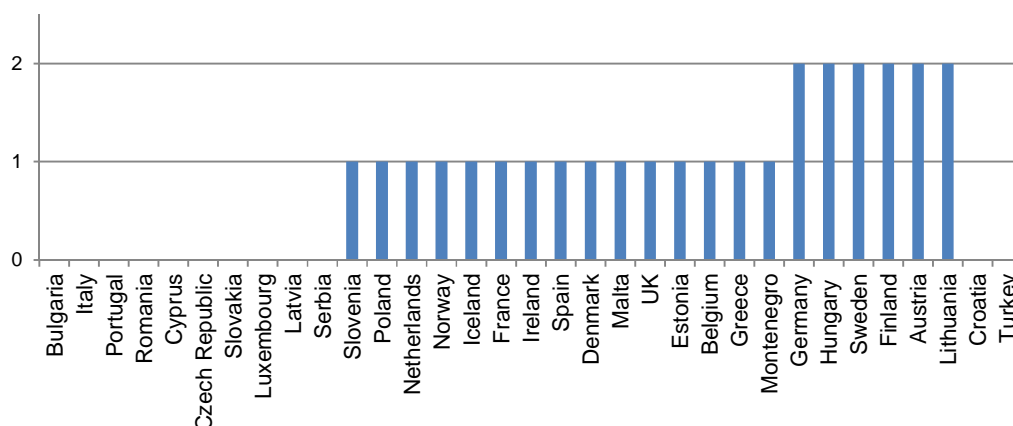
Source : ACCIs 2013 study on credit bureaus in Europe

No regulation and no oversight

The fact remains that one in three countries studied have no regulation, oversight, or minimal standards that govern PCSBs, see Figure 6.15. While half have some additional privacy rules (mainly focused on information concerning individuals and consumers), only six (or 20%) have some additional rules that govern the operations of PCSBs (for more information on those see Section 5.2.1).

Figure 6.15 Are PCSB regulated?

(0= no (besides EU's data protection directive), 1= privacy rules (besides EU's data protection directive), 2 = privacy rules + others (besides EU's data protection directive))



As mentioned earlier, this lack of oversight or standards was not always absent. The ECAI accreditation system provided the methodological oversight that gave the industry greater credibility and access to markets. This we have heard from several respondents, which viewed favourably such limited intervention, but would see full regulation (such as that for CRAs) as disproportionate and unnecessary.

⁹⁰ Association of Consumer Credit Information Suppliers

In the recent few years issues of data protection has come to the forefront of policy making and touches at the heart of PCSBs operations. The recent European Court of Justice's decision on "the right to be forgotten"⁹¹ for instance can negatively impact PCSBs' ability to perform their job, which as we have seen is of crucial importance to the functioning economy. And although the right to be forgotten goes hand in hand with the ability for a successful restart, it remains an open question how soon this should happen, or up to how many subsequent bankruptcies it should become maintained.

Given the lack of harmonisation of relevant regulation across the EU, or of an opinion about what should be considered appropriate, the issue should be of prime interest for policy makers and to be taken into account during the revision of the data protection directive.

6.4 Policy recommendations

Based on the analysis conducted we recommend the following actions in order to facilitate the positive effect of credit scoring on prevention of bankruptcy and second chance.

Reintroduce and Monitor standards of PCSBs

During this study we have heard from a couple of credit scoring bureaus of their dissatisfaction when the ECAI accreditation was closed to PCSBs. The accreditation, they claim, gave them greater legitimacy and allowed them to expand to new markets using their accredited models and practices.

The old ECAI accreditation provided standards and quality oversight, but did not constitute full regulation. This made the administrative costs for businesses bearable. However, regional differences remained in the level of oversight.

- We therefore propose to bring back such system, but focused specifically on PCSBs.
- We advise that the standards and principles are set at an EU level and take into account global principles such as of the World Bank and others.
- These standards should then be accredited and monitored, by either national institutions, or an EU body. But mutual recognition across the EU should be ensured, thus allowing the PCSB to choose their oversight body and minimising costs of duplication.

Time limit on keeping information in Credit Databases

There is a difference between the time that information is kept in credit databases, or even internal databases. In most cases these are even longer than for how long a negative scoring stays with an entrepreneur. The fact that such information exists and therefore can be used limits the possibility of entrepreneurs for a successful restart.

⁹¹ <http://curia.europa.eu/jcms/upload/docs/application/pdf/2014-05/cp140070en.pdf>

Across the EU there is no harmonised approach, or regulation on the length of time that such information should be kept. The recent European Court of Justice's decision on "the right to be forgotten" has clearly stated that such information cannot be kept forever. However, for how long it is considered in the public interest is still not defined.

- We therefore recommend that the three year discharge time (agreed to by the EC) is also applied to all types of negative information in both PCSBs and CDs.
- These limits should be enforced across the EU in a harmonised manner, considering explicitly the different types of information as well as databases.
- Furthermore any such decision should be followed up with a monitoring mechanism as well as punitive clauses.

Broader Access to Credit Databases

The collection and harmonisation of the vast information into a user friendly source is of great importance to not only PCSBs, but also to other companies, investors, banks, regulators etc. The fact that many successful commercial business models already operate in this way further adds to the value that institutions and businesses give to CDs.

However, CDs are not available in all countries in the EU to non-financial companies (i.e. except for banks). This greatly limits the efficiencies and the gains that can be made by the use of such databases. In some of the countries where CDs are not permitted, PCSBs have had to painstakingly collect the data by alternative, costlier, means.

- We therefore recommend that an agreement is made on the availability of CDs across the EU.
- Furthermore such agreement should set the type of information that will be available to CDs.
- It should also be kept in mind that the provision or collection of information must not be restricted by a country as the ultimate aim should be towards a Pan-European access to information.

Facilitate access to information

As we have seen, in some Member States the gathering and compilation of financial legal information is a difficult and costly process. This limits not only the amount of relevant information that can be gathered, but also the amount of available information that is not out-of-date. The consequence is that PCSBs are not viewed as useful as they could be, harming not only the creditors (most often suppliers, often banks, providing trade credits to their customers), but also investors and companies themselves.

- We therefore recommend to firstly investigate how best to facilitate the access to information across the EU. This is to ensure that the same basis of information is available for all Member States and that it can be easily accessible from any point in the EU. Several options should be considered from setting up an EU data portal, standardising information requirements, to ensuring all Member States follow minimal easily accessible information disclosure procedures.
- Access to data of a good quality is important especially when it comes to cross-border operations. Good information will therefore allow a supplier from for instance France to check the credit score of a company in Spain either by themselves, or using their known local PCSB. In this way risk will be decreased and trade will be done easier between new partners.
- Furthermore it will improve the operational capacity of many PCSBs and thus improve the industry as a whole. Both in terms of quality of scores and the use of scores by businesses.

Provision of sufficient financial information by micro enterprises

The Directive 2013/34/EU regarding annual accounts has enabled Member States to allow micro-entities not to publish their financial annual accounts. Although this was intended to reduce the administrative burden, it has also diminished the information available to PCSBs and CDs thus making accurate scoring nearly impossible. This lack of information can actually be counterproductive as it may even reduce the access to finance for the micro-entities⁹².

- We therefore advise to study ways in which such information can be provided by micro-entities without a substantial administrative burden. Given the rise of new ICT techniques and systems this might be possible.

⁹² See literature review for the connection between information available and access to finance see section 5.3.

7 Comparative mechanism

7.1 Introduction to the comparative mechanism

Insolvency laws, the availability and quality of support measures on prevention, second chance and arrangements on credit scoring differ widely across the 33 countries. Next to that, the chances of companies in financial distress are affected by many other factors. Therefore, we think that with so many dimensions playing a role it does not make sense to *measure* which countries are doing best and which countries are doing worst in terms of preventing bankruptcy and facilitating a second chance. *Comparing* countries with each other however gives very valuable insights, which can be used to learn from good cases.

The comparative mechanism is designed to help policy makers to get a quick overview of the main issues in the countries covered by this study, in terms of prevention and second chance. In effect it allows for quick comparisons to be made, for raising red flags and pointing toward areas for improvement, rather than conducting an evaluation and ranking countries. The different indicators will illustrate different, but complementing, ways of looking at the issues from several perspectives.

In this chapter, we will present the indicators of the comparative mechanism and a paper version of the comparative mechanism. The interactive comparative mechanism will be provided to the client separately.

7.2 Selection of indicators

We envisage two different comparison mechanisms: one looking at issues of prevention of bankruptcy, while the other looking at issues of second chance. The rationale behind separating them into two was that the measuring mechanism would better cover the complexity and specificity of each of the issues separately, rather than having one, which presents a general overview without depth.

Table 7.1 below presents the indicators for each of the measuring mechanisms. These indicators are described in detail below the table.

Table 7.1 Overview of indicators for two comparative mechanisms

Prevention comparative mechanism indicators	Second chance comparison mechanism indicators
<ul style="list-style-type: none"> • Composite World Bank index • Severity of Bankruptcy Procedure composite index • Do PCSBs exist 	<ul style="list-style-type: none"> • Composite World Bank index • Second Chance composite index • Do PCSBs exist • Discharge time of negative score from PCSBs • Discharge time of negative information from CDs
<ul style="list-style-type: none"> • Prevention Measure in step A • Prevention Measure in step B 	<ul style="list-style-type: none"> • Restart Measures in step C • Restart Measures in step D

World Bank's Ease of Doing Business Index

The reason for including this indicator is that it is the best placed indicator to describe the **legal environment** in a country in which the entrepreneur operates and the **efficiency of its institutions**. These are the two fundamental aspects that underpin the entire background for the entrepreneur and the analysis of this study.

From the overall Ease of Doing Business Index there are three indicators that are of interest to this study:

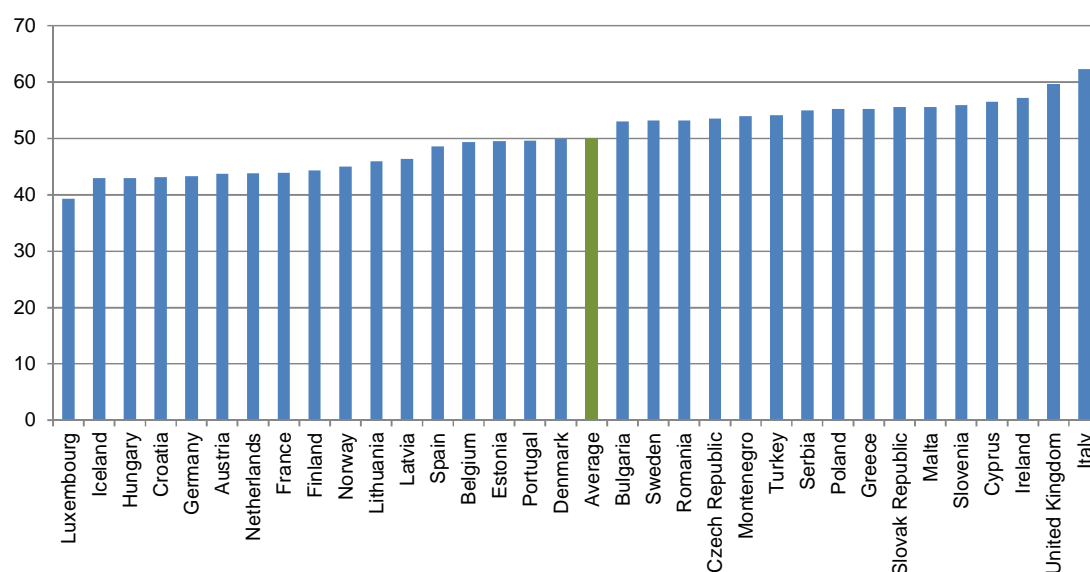
- Resolving Insolvency;
- Enforcing Contracts;
- Protecting Investors.

All three contain valuable information, but the question remains if to combine the three into a "Composite World Bank index", or use only the first "Resolving Insolvency index".

Using a statistical technique called "Anova: Two-Factor Without Replication" we have determined that the best and most relevant is to use a combination of all three indicators in the Composite World Bank index. Detailed information on the selection process and the implications can be found in Annex IV.

When we plot the index we can see the order of countries.

Figure 7.2 Composite World Bank index (the higher, the better)



Source: www.doingbusiness.org/rankings

The Bankruptcy Procedures composite index and the Second Chance composite index

The Bankruptcy Procedures composite index and the Second Chance composite index contain a compilation of the results from our country studies as explained in Sections 4.2 and 5.2 and presented in figures 4.2 and 5.4, respectively. Their aims and purposes are to show an overview of the situation in each of the countries in a consolidated, comparable and user friendly form.

The difference to the Composite World Bank index is that these indexes contain more detailed indicators focused on the topics of this study, as opposed to rather more general indicators of the

World Bank. In this way these indexes should not be viewed as competing, but rather complementary to one another.

Do PCSBs exist?

We have seen that the existence of PCSB is important in both prevention of bankruptcy as well as for second chance, as described in Section 6.

Time to erasure of negative score & information

As analysed in Section 5.3, the time that a negative score remains with an entrepreneur has significant effects on his/her ability to a successful restart. The same applies for negative information that remains available somewhere in the system.

We have also seen that the duration of the erasure differs significantly between the countries analysed. For this reason the two indicators have been included in the second chance comparison mechanism.

Preventive measures in Steps A & B and second chance measures in Steps C & D

In both Steps A and step B of the preventive process⁹³ there are several measures that help to facilitate, or constitute as preventive actions. The same applies for Steps C and D in facilitating a second chance.⁹⁴

Given that there are significant differences between the countries studied we have included a list under each country of the preventive or second chance measures in the two comparative mechanism. This aims to give a quick overview of the types of measures found in each country, while in Annex II we provide a more detailed list of all the measures found.

7.3 Outputs of the comparative mechanism

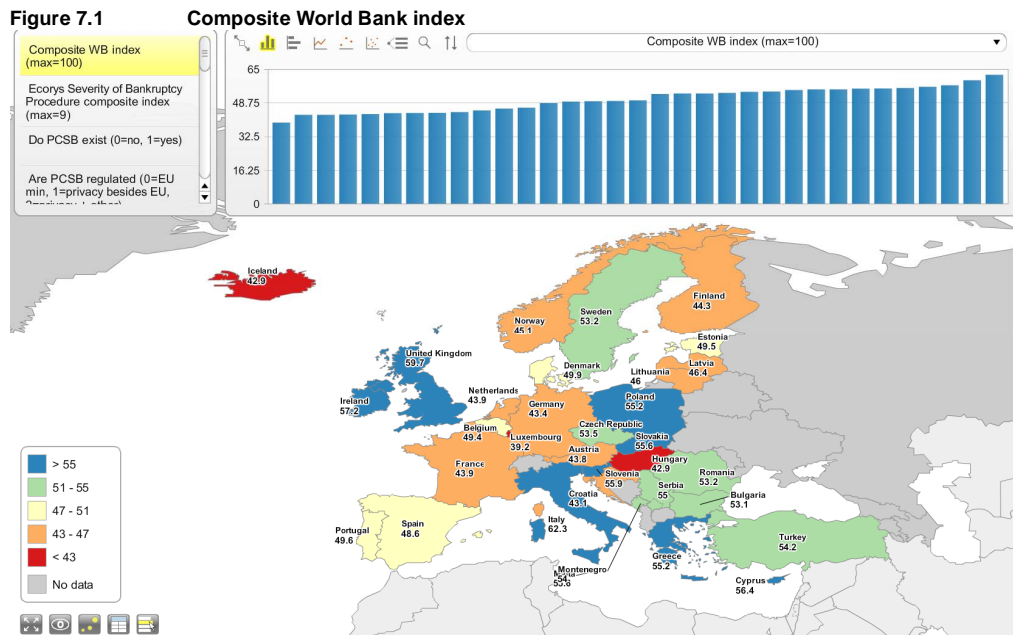
In this section, some findings are presented that have been made possible with the use of the comparative mechanism. All these can be found using the interactive comparative mechanism (see Section 7.4).

Geographical difference in World Bank performance

In terms of the World Bank index, the eastern European countries seem to perform better compared to the more developed western neighbours. This could be associated with legislative reforms that needed to be undertaken as part of the accession procedures to the EU (in 2004 and 2007) as well as the possibility to pass completely new legislation that was based on the latest insights during the past 20-25 years.

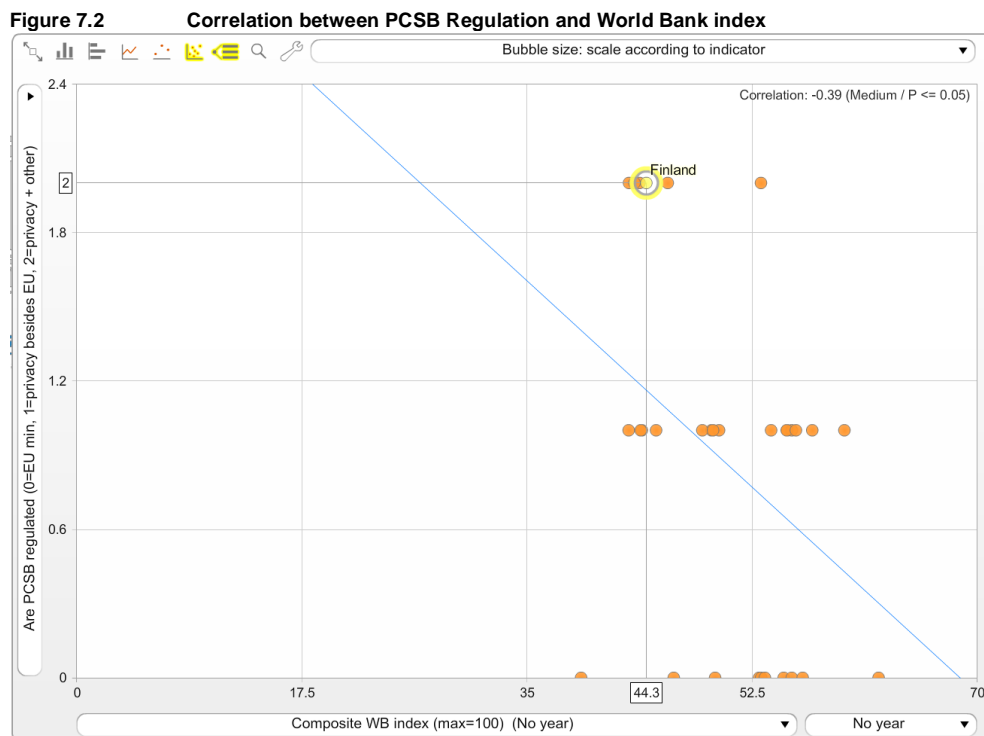
⁹³ For diagram and explanation please see Section 3.1.

⁹⁴ For diagram and explanation please see Section 4.1.



Regulation of PCSBs and Composite World Bank Index

We have found that there is a negative correlation⁹⁵ between the level to which PCSBs are regulated and the Composite World Bank Index. This means that the more regulation you have on PCSBs the lower your Composite World Bank Index is.

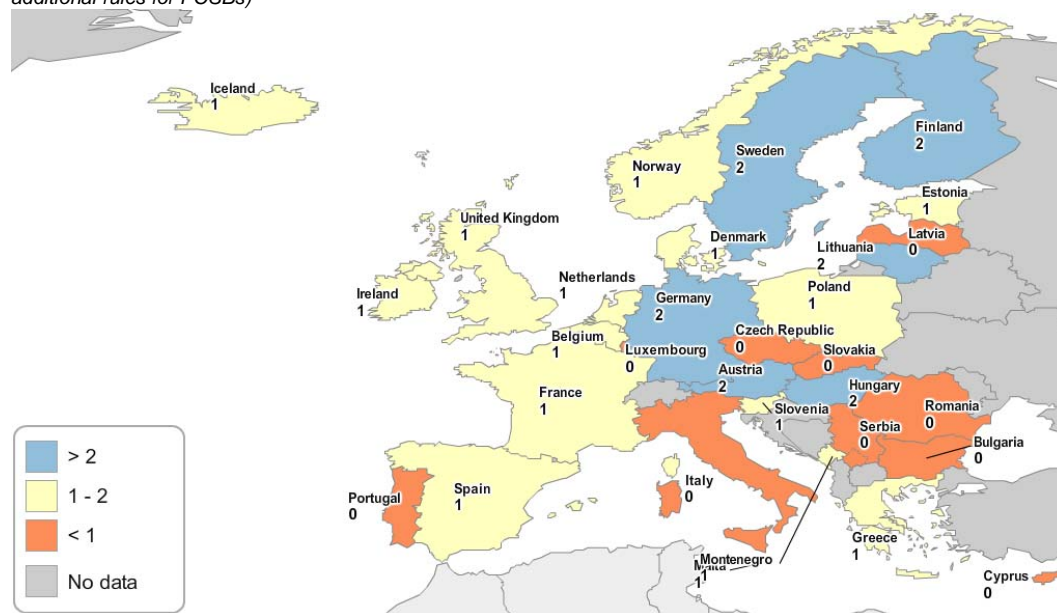


⁹⁵ At 95% confidence.

If we link this finding to the previous one, an explanation may be that as Eastern European Countries were busy reforming their general legal systems, Central European countries used the time to improve regulation on PCSBs. This can also be seen in map of those countries with the level of PCSB regulation, see Figure 7.3 below.

Figure 7.3 Level of regulation of PCSBs

(0 orange = no; 1 yellow = privacy protection rules besides EU ones; 2 blue = privacy protection rules + additional rules for PCSBs)



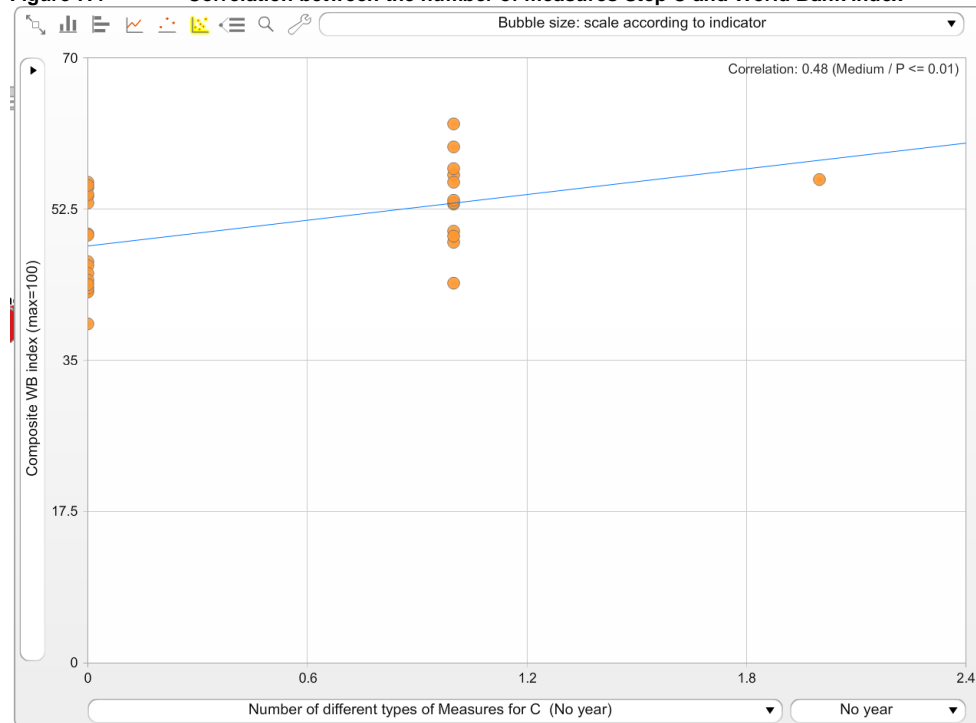
Composite World Bank Index and number of measures Step C

There is a medium positive correlation⁹⁶ between the number of measure for Step C per country and its Composite WB score, see Figure 7.4 below. In other words, the better the legal environment (Composite WB index) the more bankruptcy settlement measures the country has (Measure C, mainly focused on discharge).

This makes sense since Step C is also to an extent a description of the efficiency of the legal system and therefore the two should indeed be positively correlated.

⁹⁶ At 99% confidence.

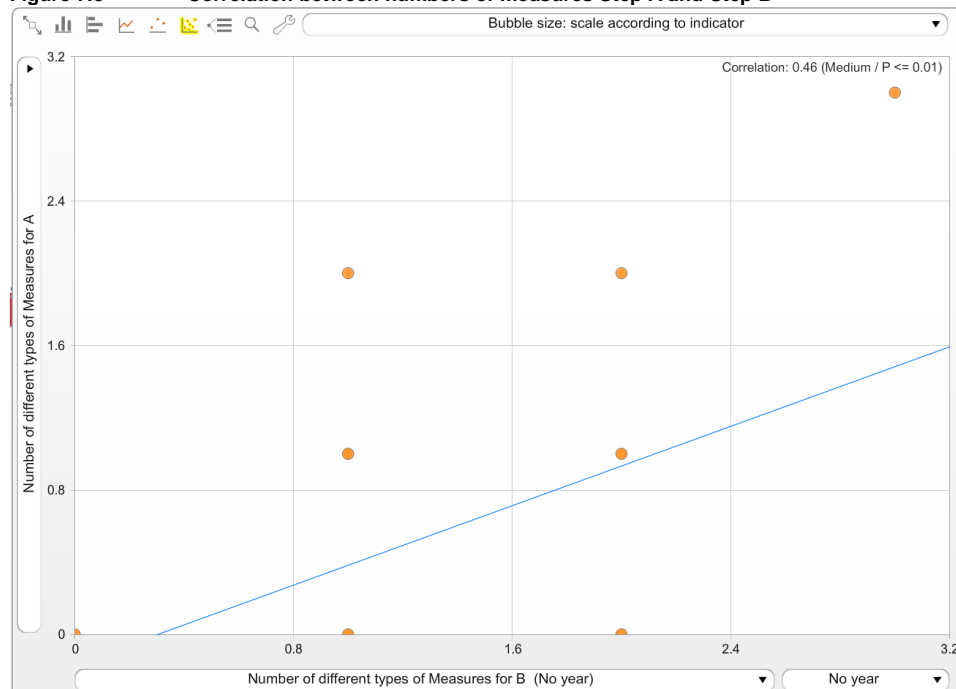
Figure 7.4 Correlation between the number of measures Step C and World Bank index



Number of measures Step A and number of measures Step B correlated

There is a positive medium correlation⁹⁷ between the number of measures of Step A and the number of measures of Step B per country. In other words, if a country has several Measures A it is likely to also have several Measures B. From this we can deduct that if a country engages in prevention it does so in both of the preventive steps (A&B).

Figure 7.5 Correlation between numbers of measures Step A and Step B



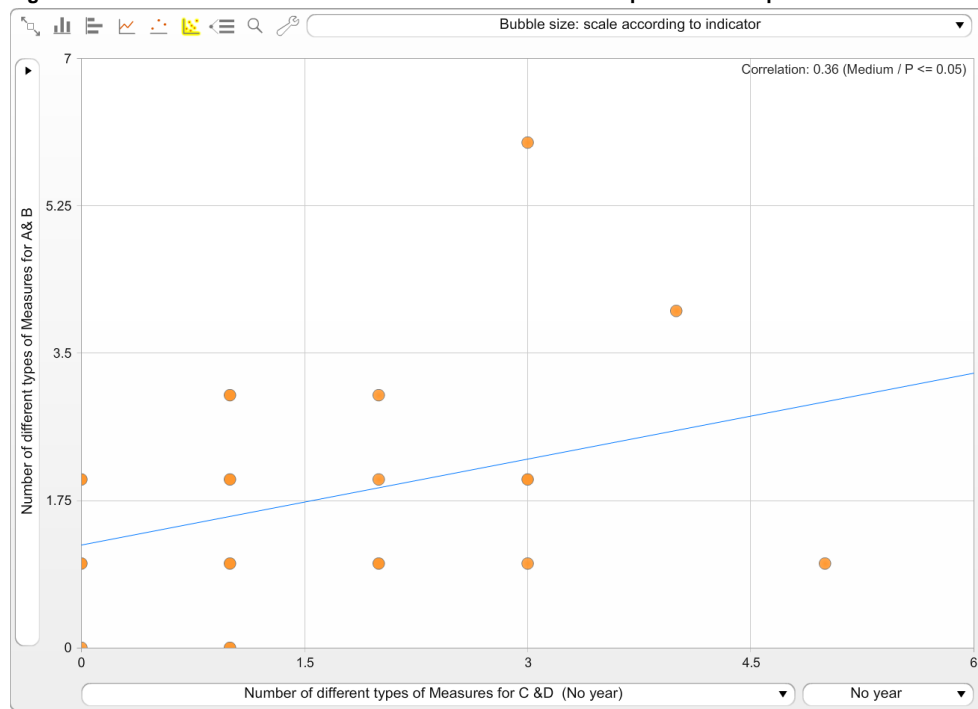
⁹⁷ At 99% confidence.

Interestingly we have found that this is not the case between the number of measures of Step C and the number of measures of Step D. Therefore no such trend occurs in terms of second chance.

Number of Measures A + B and number of Measures C + D = positive correlation

The number of Measures A+B are positively correlated⁹⁸ to the number of Measures C+D. In other words, if a country has measures for prevention it is likely to also have measures for second chance.

Figure 7.6 Correlation between numbers of measures Step A+B and Step C+D



7.4 Link to the interactive version of the comparative mechanism

In the interactive version of the comparative mechanism, all indicators are put in one system.

The interactive comparative mechanism on Prevention of Bankruptcy can be accessed via the following link: <https://webapps.ecorys.com/maps/client/map1/StatPlanet.html>

The interactive comparative mechanism on Second Chance can be accessed via the following link: <https://webapps.ecorys.com/maps/client/map2/StatPlanet.html>

⁹⁸ At 95% confidence.

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Annex II: List of support measures

For all stages of prevention and second chance (A, B, C and D), countries may have public or private support measures in place. Table II.1 below presents the measures that were identified by the 33 country experts.

Table II.1 Identified support measures for prevention and second chance

Country	Stage	Measure category	Name/type of measure	Institution
Austria	A	Information campaigns	N.a.	Austrian Chamber of Commerce
	B	Free or sponsored consulting advice	Servicepaket zur Unternehmenssicherung des WIFI Wien	SOLL&Haberfellner Unternehmens- und Projektberatung
	C	No measures		
	D	No measures		
Belgium	A	Early warning (based upon accountants, banks etc.)	Federal Law on the Continuity of Enterprises (LCE) (WCO)	Accountants
		Automatic warning (based upon check of balance sheets)	N.a.	Chambers of Commercial Inquiry
		Information campaigns	N.a.	Brussels Centre des Entreprises en Difficulte (regional organisation)
	B	Out-of-court pre-bankruptcy settlement (including mediation)	Federal Law on the Continuity of Enterprises (LCE) (WCO)	Debtors and creditors
		Free or sponsored consulting advice	N.a.	Flemish Enterprise Agency (regional department of economy)
		Free or sponsored consulting advice	N.a.	Tussenstap (private organisation)
		Free or sponsored consulting advice	N.a.	Efrem (private organisation)
		Free or sponsored consulting advice	N.a.	Brussels Centre des Entreprises en Difficulte (regional organisation)
		Free or sponsored legal and accounting services	N.a.	Brussels Centre des Entreprises en Difficulte (regional organisation)
		Free or sponsored consulting advice	N.a.	Centre des Entreprises en Difficulte Wallonia (regional organisation)
	C	Advice services on discharge procedures	N.a.	Tussenstap (private organisation)
		Advice services on discharge procedures	Agricultural activities	Boere op een Kruispunt
		Advice services on discharge procedures	Small and micro entrepreneurship	Microstart (private organization)
	D	Access to start-up finance	Mixed financing instrument	Flemish Enterprise Agency (regional department of economy)
		Access to start-up finance	Small and micro entrepreneurship	Microstart (private organization)
		Access to start-up finance	Mixed financing instrument	Hefboom (private organization)
		Access to start-up finance	Mixed financing instrument	Sowalfin (regional agency)

Country	Stage	Measure category	Name/type of measure	Institution
		2nd chance coaching and education	N.a.	Tussenstap (private organisation)
Bulgaria	A	No measures		
	B	Out-of-court pre-bankruptcy settlement (including mediation)	N.a.	Debtors and creditors
	C	Recovery proceedings	N.a.	District court
	D	No measures		
Croatia	A	No measures		
	B	Out-of-court pre-bankruptcy settlement	N.a.	FINA (state financial agency)
		Tax re-payment plans	Re-programme of tax debt	Tax authority
	C	No measures		
	D	Awareness raising	N.a.	Ministry of Economy
		Awareness raising	N.a.	Ministry of Entrepreneurship and Crafts
Cyprus	A	No measures		
	B	No measures		
	C	Efforts to simplify or shorten discharge	Individuals, full discharge after 4 years	Official receiver
	D	No measures		
Czech Republic	A	No measures		
	B	Out-of-court pre-bankruptcy settlement	N.a.	Debtors and creditors
	C	Efforts to simplify or shorten discharge	Small companies	Ministry of Finance
	D	No measures		
Denmark	A	No measures		
	B	Free or sponsored consulting advice	"Early Warning"	Væksthusene (regional business development centres)
		Free or sponsored legal and accounting services	"Early Warning"	Væksthusene (regional business development centres)
	C	Efforts to simplify or shorten discharge	N.a.	Ministry of Economy
	D	No measures		
Estonia	A	Automatic warning (based upon check of balance sheets)	e-Business Register	Estonian Centre of Registers and Information Systems
	B	Out-of-court pre-bankruptcy settlement	N.a.	Court of Arbitration at Estonian Chamber of Commerce and Industry
	C	No measures		

Country	Stage	Measure category	Name/type of measure	Institution
	D	Public support measures	N.a.	
Finland	A	No measures		
	B	Free or sponsored consulting advice	Talousapu service	Ministry of Employment and the Economy
	C	No measures		
	D	No measures		
France	A	Early warning (based upon accountants, banks etc.)	N.a.	Accountants
		Early warning (based upon accountants, banks etc.)	N.a.	Tribunal of commerce
		Information campaigns	N.a.	General Confederation of Small and Medium Sized Enterprises
	B	Out-of-court pre-bankruptcy settlement (including mediation)	Le mandat AD HOC	Entreprisendifficulté
		Out-of-court pre-bankruptcy settlement (including mediation)	La conciliation	Entreprisendifficulté
		Free or sponsored consulting advice	N.a.	Chambers of Commerce and Industry
		Free or sponsored consulting advice	Assurance sante entreprise	Centre d'information sur la prevention des difficultes des entreprises
		Free or sponsored consulting advice	SOS Entrepreneur	Sauver et Développer les Entreprises du NPDC
	C	Assistance in debt negotiations	N.a.	CCSF (public organization)
	D	Efforts toward cancelation of a record in a public database	FIBEN 040	N.a.
		Awareness raising	Conference on 2nd chance	Associations for entrepreneurs
		Access to start-up finance	N.a.	Initiative France
Germany	A	No measures		
	B	Free or sponsored consulting advice	Turn Around Consultancy (Turn Around Beratung)	KfW (public business development bank)
		Free or sponsored consulting advice	Round Table (Runder Tisch)	KfW (public business development bank)
	C	No measures		
	D	Public support measures	Support to pay external consultancy	N.a.
		Guidelines for re-starters	N.a.	Ministry of Economy and Energy
		2nd chance coaching and education	N.a.	Non-profit organizations
		Awareness raising	N.a.	Non-profit organizations
		Access to start-up finance	Low interest loans	KfW (public business development bank)
		Access to start-up finance	N.a.	N.a.

Country	Stage	Measure category	Name/type of measure	Institution
Greece	A	No measures		
	B	Out-of-court pre-bankruptcy settlement (including mediation)	N.a.	N.a.
	C	No measures		
	D	No measures		
Hungary	A	No measures		
	B	Out-of-court pre-bankruptcy settlement (including mediation)	N.a.	N.a.
	C	No measures		
	D	No measures		
Iceland	A	No measures		
	B	Free or sponsored consulting advice	N.a.	Innovation Centre Iceland
	C			
	D	Access to start-up finance Access to start-up finance Access to start-up finance	N.a. Support of specific projects N.a.	Innovation Centre Iceland Icelandic Centre for Reserach NSA Ventures
Ireland	A	No measures		
	B	Out-of-court pre-bankruptcy settlement (including mediation)	Debt Relief Notice (DRN)	Insolvency Service of Ireland
		Out-of-court pre-bankruptcy settlement (including mediation)	Debt Settlement Arrangement (DSA)	Insolvency Service of Ireland
		Out-of-court pre-bankruptcy settlement (including mediation)	Personal Insolvency Arrangement (PIA)	Insolvency Service of Ireland
	C	Efforts to simplify or shorten discharge	Full discharge in 3 years	N.a.
	D	Assistance with access to finance	Review of unfairly declined applications	Credit Review Office
Italy	A	No measures		
	B	Out-of-court pre-bankruptcy settlement (including mediation)	Concordato preventivo	Court
		Out-of-court pre-bankruptcy settlement (including mediation)	Accordo di ristrutturazione dei debiti	Court
		Out-of-court pre-bankruptcy settlement (including mediation)	Piano attestato di risanamento	Independent expert
	C	Efforts to simplify or shorten discharge	Full discharge in 1 year upon certain conditions	Court
	D	No measures		
Latvia	A	No measures		
	B	Out-of-court pre-bankruptcy settlement	Out-of-Court Debt Restructuring	Debtors and creditors
	C	No measures		

Country	Stage	Measure category	Name/type of measure	Institution
	D	Public support measures	No restrictions to register a new company after bankruptcy	Enterprise register
Lithuania	A	Automatic warning (based upon check of balance sheets)	N.a.	State Tax Inspectorate
		Automatic warning (based upon check of balance sheets)	N.a.	Centre of Registers
	B	Tax re-payment plans	N.a.	State Tax Inspectorate
	C			
	D	Public support measures	N.a.	N.a.
		Access to start-up finance	N.a.	N.a.
		Awareness raising	Support seminars	Enterprise Lithuania (national agency)
Luxembourg	A	Training	LSC-Entrepreneurship	Luxembourg School for Commerce (part of Chamber of Commerce)
	B	Free or sponsored consulting advice	VaccinAntiCrise	Chamber of Commerce
		Out-of-court pre-bankruptcy settlement	Concordat préventif de faillite	Debtors and creditors
		Out-of-court pre-bankruptcy settlement (including mediation)	Gestion contrôlée	External administrator
	C	No measures		
	D	2nd chance coaching and education	Company administration training	Ministry of Economy and SMEs
Malta	A	Websites/online portals with information on prevention	N.a.	Malta Enterprise (Business First Unit)
	B	Free or sponsored consulting advice	N.a.	Malta Enterprise (Business First Unit)
		Free or sponsored consulting advice	Article 329B of the Companies Act 1995: company recovery application	Court
		Out-of-court pre-bankruptcy settlement (including mediation)	N.a.	Mediation Centre
	C	No measures		
	D	Individual can start a new company even in the course of bankruptcy procedures	N.a.	N.a.
		Access to start-up finance	N.a.	N.a.
Montenegro	A	No measures		
	B	Out-of-court pre-bankruptcy settlement (including mediation)	N.a.	The Centre for Mediation of Montenegro
		Tax re-payment plans	N.a.	Tax Administration
		Tax re-payment plans	N.a.	Customs Administration of Montenegro
	C	No measures		

Country	Stage	Measure category	Name/type of measure	Institution
	D	No measures		
Netherlands	A	Information campaigns	Geldboek voor Ondernemers (Moneybook for Entrepreneurs)	Ministry of Economic Affairs
		Websites/online portals with information on prevention	N.a.	Ministry of Economic Affairs
	B	Free or sponsored consulting advice	Coaching	Qredits (Microfinance institution)
		Free or sponsored consulting advice	Ondernemersklankbord (Entrepreneurs Sparring)	Ondernemersklankbord (NGO)
		Free or sponsored consulting advice	MKB Doorstart	Ondernemersplein (platform for entrepreneurs)
	C	No measures		
	D	Access to start-up finance	N.a.	N.a.
Norway	A	Websites/online portals with information on prevention	N.a.	Norwegian Altinn (part of Brønnoysundsregistrene)
	B	Free or sponsored consulting advice	website	Norwegian Altinn (part of Brønnoysundsregistrene)
		Free or sponsored consulting advice	Business Information Services (call centre)	Norwegian Altinn (part of Brønnoysundsregistrene)
	C	No measures		
	D	No measures		
Poland	A	No measures		
	B	Free or sponsored consulting advice	Instrument of Quick Response (2009-2014)	Polish Agency for Enterprise Development (PARP)
	C	No measures		
	D	No measures		
Portugal	A	No measures		
	B	No measures		
	C	No measures		
	D	Access to start-up finance	N.a.	N.a.
Romania	A	No measures		
	B	Free or sponsored consulting advice	Ad-hoc mandate (Law 381 / 2009)	Court
		Out-of-court pre-bankruptcy settlement (including mediation)	Pre-insolvency consensus (Law 381 / 2009)	Debtors and creditors
	C	Honest individual entrepreneurs face no financial consequences	N.a.	N.a.
	D	No measures		
Serbia	A	No measures		

Country	Stage	Measure category	Name/type of measure	Institution
	B	Out-of-court pre-bankruptcy settlement (including mediation)	Pre-packed reorganisation plans (PPRP)	Court
		Out-of-court pre-bankruptcy settlement (including mediation)	Voluntary financial restructuring	Chamber of Commerce
	C	No measures		
	D	No measures		
Slovakia	A	Websites/online portals with information on prevention	www.podnikam.webnoviny.sk	N.a.
	B	Free or sponsored consulting advice	Initial consultation free of charge	LIEB restrukturalizacie
		Free or sponsored consulting advice	Initial consultation free of charge	DRS (Debt Reduction Solutions)
		Free or sponsored consulting advice	Initial consultation free of charge	Slovak Chamber of Tradesmen
		Free or sponsored consulting advice	Initial consultation free of charge	Slovak Federation of Tradesmen
		Free or sponsored consulting advice	Initial consultation free of charge	Slovak Trade and Industry Chamber
		Free or sponsored consulting advice	Initial consultation free of charge	Alliance of Slovak Entrepreneurs
		Free or sponsored consulting advice	Initial consultation free of charge	Slovak Business Agency
	C	Advice services on discharge procedures	Initial consultation free of charge	Alliance of Slovak Entrepreneurs
		Advice services on discharge procedures	Initial consultation free of charge	Slovak Business Agency
		Advice services on discharge procedures	Initial consultation free of charge	Slovak Chamber of Tradesmen
	D	No measures		
Slovenia	A	No measures		
	B	Out-of-court pre-bankruptcy settlement (including mediation)	Financial Operations, Insolvency Proceedings and Compulsory Dissolution Act, 6th amendment, Dec 2013	Court
	C	Efforts to simplify or shorten discharge	SME fast track	N.a.
		Possibility to retain items needed for a new business	Upon request	Court
	D	Individual can start a new company even in the course of bankruptcy procedures	Upon approval of the court	Court
Spain	A	Early warning (based upon accountants, banks etc.)	N.a.	Auditors
		Early warning (based upon accountants, banks etc.)	Relanza	Superior Council of Chambers of Commerce
	B	Out-of-court pre-bankruptcy settlement (including mediation)	Entrepreneur Law 14/2013 and Insolvency Law art. 71.6	Court
	C	Recovery proceeding	Possibility to forgive a part of the public debt	N.a.
		Recovery proceedings	Relanza	Superior Council of Chambers of Commerce

Country	Stage	Measure category	Name/type of measure	Institution
	D	Access to start-up finance	N.a.	N.a.
		Public support measures	Free access to public procurement	N.a.
Sweden	A	No measures		
	B	Free or sponsored consulting advice	Företagsakuten	Regional business organisations
	C	No measures		
	D	Access to start-up finance	N.a.	N.a.
		Public support measures	N.a.	N.a.
Turkey	A	No measures		
	B	No measures		
	C	No measures		
	D	No measures		
UK	A	Early warning (based upon accountants, banks etc.)	N.a.	Banks
	B	Out-of-court pre-bankruptcy settlement (including mediation)	Individual Voluntary Arrangements	Licensed insolvency practitioners
		Out-of-court pre-bankruptcy settlement (including mediation)	Company Voluntary Arrangements	Licensed insolvency practitioners
	C	Efforts to simplify or shorten discharge	Automatic discharge shortened for 12 months	N.a.
	D	Individual can start a new company even in the course of bankruptcy procedures	N.a.	N.a.

Annex III: List of Private Credit Scoring Bureaus

Name	Country	Type
Kreditschutzverband von 1870	Austria	CD & PCSB
Bisnode	Austria	PCSB
Creditreform Wirtschaftsauskunftei Kubicki KG	Austria	PCSB
Alpenländischer Kreditorenverband für Kreditschutz und Betriebswirtschaft (AKV)	Austria	PCSB
CRIF GmbH (vormals Deltavista)	Austria	PCSB
Dun & Bradstreet Information Services Gesellschaft m.b.H	Austria	PCSB
FirmenABC Marketing GmbH	Austria	PCSB
GBI-Genios Deutsche Wirtschaftsdatenbank GmbH	Austria	PCSB
Intrum Justitia GmbH	Austria	PCSB
Banque Nationale de Belgique	Belgium	CD
B-Information	Belgium	PCSB
Duns and Bradstreet	Belgium	PCSB
Creditsafe	Belgium	PCSB
Company web	Belgium	PCSB
Graydon Belgium	Belgium	PCSB
BCRA-Credit Rating Agency AD	Bulgaria	CRA & PCSB
Bulgarian Rating Agency (BRA)	Bulgaria	PCSB
HROK Croatian Credit Information Registry	Croatia	CD
Moody's Investors Service Cyprus Ltd	Cyprus	CRA
Capital Intelligence (Cyprus) Ltd	Cyprus	CRA
Artemis	Cyprus	CD & PCSB
The Insolvency Register	Czech Republic	CD
The Central Credit Register	Czech Republic	CD
SOLUS , Interest group of legal persons	Czech Republic	CD
BPX.cz	Czech Republic	CD
Client Information Bank Register (BRCI)	Czech Republic	CD
Non-bank Client Information Register (NRCI)	Czech Republic	CD
Central Debtors Register of the Czech Republic (CERD),	Czech Republic	CD
CRIF – Czech Credit Bureau, a.s	Czech Republic	CD & PCSB
Duns & Bradstreet	Czech Republic	PCSB
Debitor Registret A/S	Denmark	CD
Experian	Denmark	CD & PCSB
Bisnode Credit (former Soliditet) – cooperates with D&B Denmark (same address)	Denmark	PCSB
Intrum Justitia	Denmark	PCSB
Dansk KreditorService	Denmark	PCSB
Atradius A/S	Denmark	PCSB
Euro Capital A/S	Denmark	PCSB
AS Kredidiinfo	Estonia	PCSB
Suomen Asiakastieto OY	Finland	CD
Suomen Asiakastieto OY	Finland	PCSB
Bisnode Finland Oy	Finland	PCSB

Name	Country	Type
Intrum Justitia Oy	Finland	PCSB
Euler Hermes Service AB	Finland	PCSB
Fitch France S.A.S.	France	CRA
Moody's France S.A.S.	France	CRA
Standard & Poor's Credit Market Services France S.A.S.	France	CRA
Spread Research	France	CRA
Banque de France	France	PCSB
Coface (now Ellisphere)	France	PCSB
société.com	France	PCSB
Infogreffe	France	PCSB
Altarex	France	PCSB
Creditsafe	France	PCSB
Euler Hermes Rating GmbH	Germany	CRA
Feri EuroRating Services AG	Germany	CRA
Creditreform Rating AG	Germany	CRA
Scope Ratings GmbH	Germany	CRA
GBB-Rating Gesellschaft für Bonitätsbeurteilung GmbH	Germany	CRA
ASSEKURATA Assekuranz Rating-Agentur GmbH	Germany	CRA
Fitch Deutschland GmbH	Germany	CRA
Moody's Deutschland GmbH	Germany	CRA
infoscore Consumer Data GmbH	Germany	CD
SCHUFA Holding AG	Germany	CD & PCSB
Creditreform Boniversum GmbH	Germany	CD & PCSB
Bürgel Wirtschaftsinformationen GmbH & Co. KG	Germany	CD & PCSB
Arvato	Germany	PCSB
Bisnode Deutschland GmbH	Germany	PCSB
Kredit-Control GmbH	Germany	PCSB
Creditsafe Deutschland GmbH	Germany	PCSB
Deltavista GmbH	Germany	PCSB
Scoredex GmbH	Germany	PCSB
ICAP Group	Greece	CRA & PCSB
Tiresias SA	Greece	CD & PCSB
BISZ Central Credit Information Plc	Hungary	CD
Company Information Office	Hungary	CD
OPTEN Ltd.	Hungary	PCSB
VOXINFO Ltd.	Hungary	PCSB
BISNODE Group member in Hungary, D&B Bisnode Hungary	Hungary	PCSB
Wolters Cluver L.t.d.	Hungary	PCSB
Atradius	Hungary	PCSB
Coface Hungary Credit Management Services Ltd.	Hungary	PCSB
Credit Info	Iceland	CD & PCSB
Irish Credit Bureau	Ireland	CD & PCSB
Experian Ireland	Ireland	PCSB
Businesspro/Stubbs Gazette	Ireland	PCSB
Fitch Italia S.p.A.	Italy	CRA
Moody's Italia S.r.l.	Italy	CRA
Standard & Poor's Credit Market Services Italy S.r.l.	Italy	CRA
CRIF S.p.A.	Italy	CRA

Name	Country	Type
Cerved Rating Agency S.p.A. (previously CERVED Group S.p.A.)	Italy	CRA
Dagong Europe Credit Rating Srl (Dagong Europe)	Italy	CRA
CRIF Rating Agency	Italy	CD & PCSB
Cerved Group Spa	Italy	CD & PCSB
GIB Italia Service s.r.l.	Italy	PCSB
Balt Risk Ltd.	Latvia	PCSB
CREDITREFORM Latvija Ltd.	Latvia	PCSB
Creditinfo Latvija Ltd.	Latvia	PCSB
JSC ARCIS	Latvia	PCSB
CREDITINFO	Lithuania	PCSB
Creditreform	Lithuania	PCSB
Coface	Lithuania	PCSB
Gelvora	Lithuania	PCSB
Creditreform SA	Luxemburg	PCSB
Infocredit	Malta	PCSB
Credit Risk Limited	Malta	PCSB
Credit Regulatory Register	Montenegro	PCSB
BKR Stichting Bureau Krediet Registratie	Netherlands	CD
Experian Nederland B.V.	Netherlands	CD & PCSB
BIS Consumerdata	Netherlands	PCSB
Cardec B.V.	Netherlands	PCSB
CompanyInfo	Netherlands	PCSB
Dun & Bradstreet B.V.	Netherlands	PCSB
EDR Credit Services B.V.	Netherlands	PCSB
Focum	Netherlands	PCSB
Graydon Nederland B.V.	Netherlands	PCSB
ISN Informatie en Incasso B.V.	Netherlands	PCSB
Informatiebureau "Nobel"	Netherlands	PCSB
Informatieteam B.V.	Netherlands	PCSB
Modint B.V.	Netherlands	PCSB
Creditsafe	Netherlands	PCSB
Experian Norway	Norway	CD
Bisnode Credit AS (tidl AAA Soliditet AS)	Norway	PCSB
EVRY AS	Norway	PCSB
Eniro Norge (markedsføres under navnet Proff Forvalt),	Norway	PCSB
Atradius Buyer Ratings	Norway	PCSB
Kredittfakta AS	Norway	PCSB
Fitch Polska S.A.	Poland	CRA
EuroRating Sp. z o.o.	Poland	CRA & PCSB
BIK	Poland	CD & PCSB
Biuro Informacji Gospodarczej InfoMonitor S.A.	Poland	CD & PCSB
Krajowy Rejestr Długów Biuro Informacji Gospodarczej SA	Poland	CD & PCSB
Infocredit	Poland	CD & PCSB
Krajowe Biuro Informacji Gospodarczej (KBIG)	Poland	PCSB
Rejestr Dłużników ERIF	Poland	PCSB

Name	Country	Type
Euler Hermes Services Polska Sp. z o.o.	Poland	PCSB
Fitch Polska, S.A. Poland	Poland	PCSB
Agencja Ratingu Społecznego Sp. z o.o.	Poland	PCSB
Dun & Bradstreet Poland	Poland	PCSB
ARC Ratings, S.A. (previously Companhia Portuguesa de Rating, S.A)	Portugal	CRA
Informa DB	Portugal	PCSB
IGNIOS (ex- COFACE)	Portugal	PCSB
Credinformação (EQUIFAX)	Portugal	PCSB
IIC - Informador Comercial	Portugal	PCSB
Racius (Nexexperience)	Portugal	PCSB
S.C. Biroul de Credit S.A.	Romania	CD
COFACE SRBIJA d.o.o.	Serbia	PCSB
Rating DOO	Serbia	PCSB
Solvent point DOO	Serbia	PCSB
Bisnode d.o.o.	Serbia	PCSB
Poslovni Plan doo	Serbia	PCSB
Insolvency register,	Slovakia	CD
The Slovak Banking Credit Bureau, s.r.o.	Slovakia	CD
CERD – Central register of debtors	Slovakia	CD
Non-bank register of client information (NRKI)	Slovakia	CD
European Rating Agency, a.s.	Slovakia	CRA
CRIF – Slovak Credit Bureau, a.s.	Slovakia	CD & PCSB
CRIBIS – Universal register	Slovakia	PCSB
SOLUS – interest group of legal persons	Slovakia	PCSB
Kreditni Biro Sisbon, D.O.O.	Slovenia	CD
Bisnode	Slovenia	CD
AJPES	Slovenia	CD
Creditreform	Slovenia	PCSB
Bonitetna hiša i	Slovenia	PCSB
The Central Credit Register (CIR or CIRBE)	Spain	CD
The Registro de Aceptaciones Impagadas – RAI	Spain	CD
EQUIFAX SERVICIOS SOBRE SOLVENCIA Y CREDITO S.L..	Spain	CD
Fitch Ratings España S.A.U.	Spain	CRA
Moody's Investors Service España S.A.	Spain	CRA
Axesor SA	Spain	CRA & PCSB
Experian	Spain	CD & PCSB
Informa	Spain	PCSB
CreditSafe I Sverige AB	Sweden	CD & PCSB
Bisnode Kredit AB	Sweden	PCSB
Business Check I Sverige AB	Sweden	PCSB
Decidas Info AB	Sweden	PCSB
DoubleCheck AB	Sweden	PCSB
Dun & Bradstreet Sverige AB	Sweden	PCSB
Syne AB	Sweden	PCSB
UC AB	Sweden	PCSB

Name	Country	Type
Intrum Justitia Sverige AB	Sweden	PCSB
Neufeld's Creditinformation	Sweden	PCSB
Svefo Sverige AB	Sweden	PCSB
Transcom Credit Management Services AB	Sweden	PCSB
KKB Kredi Kayit Bürosu A.S.	Turkey	CD
AM Best Europe-Rating Services Ltd. (AMBERS)	United Kingdom	CRA
DBRS Ratings Limited	United Kingdom	CRA
Fitch Ratings Limited	United Kingdom	CRA
Fitch Ratings CIS Limited	United Kingdom	CRA
Moody's Investors Service Ltd	United Kingdom	CRA
Standard & Poor's Credit Market Services Europe Limited	United Kingdom	CRA
The Economist Intelligence Unit Ltd	United Kingdom	CRA
Equifax Ltd	United Kingdom	CD & PCSB
Callcredit Plc	United Kingdom	CD & PCSB
Experian Ltd	United Kingdom	CD & PCSB
Graydon	United Kingdom	PCSB
Dun & Bradstreet	United Kingdom	PCSB
Jordans & Company watch	United Kingdom	PCSB
Creditsafe	United Kingdom	PCSB

Annex IV: Selection of World Bank Composite Index

Selection process

To conduct our analysis we took the World Bank's raw data and created three indexes to allow for comparison and analysis:

- Resolving Insolvency index (*composing of that single indicator*)
- Composite WB index (*composing of the combination of the three indicators identified above*)
- Total WB index (*composing of all three indicators*)

We have then conducted a statistical **Anova: Two-Factor Without Replication** analysis to try to see if there was any sense in even considering one of the two options.

This was done hoping to disprove the two "zero hypothesis":

- That all means are equal (meaning all the indicators are the same);
- There is no correlation between the indicators (meaning the numbers are random).

ANOVA: Two-Factor Without Replication

Source of Variation	Sum of Squares	degrees of freedom	Mean square	F-statistic	P-value	F crit
Rows	2523.138	32	78.84808	4.425864	2.11E-07	1.623862
Error	1140.179	64	17.8153			
Total	5963.225	98				
α	0.05					

H₀ (zero hypothesis) All means are equal

H₀ (zero hypothesis) There is no correlation between the indicators

The fact that the *F-statistic* is greater than the *F critical value* and that the *P-value* is smaller than *alpha(α)* means that we can **reject the zero hypothesis**. In another words the sample is neither the same, nor random and therefore it makes sense to carry on with the investigation.

Common sense as well as statistics⁹⁹ pointed to the evident fact that the "**Composite WB index**" **had more explanatory power than the "Resolving Insolvency Index"**.

Although this might appear evident we can demonstrate it on a concrete example of Belgium. Here we see great disparity between the three indexes, but the Composite WB index has a lower Variance compared to the Resolving insolvency index and is therefore more reliable.

	Resolving Insolvency index	Composite WB index	Total WB index
Belgium	33	49	52

⁹⁹ We conducted an analysis of the different variations, correlations as well as F-tests, that all pointed in the same direction

In another words the Composite WB index (by its nature) is less susceptible to rely on a few indicators and it **is therefore better at determining an overall status of the environment** (which is the aim of this indicator in the overall measuring mechanism), compared to the Resolving Insolvency index.

For this reason we **have selected to use the Composite WB index** in this measuring mechanism.

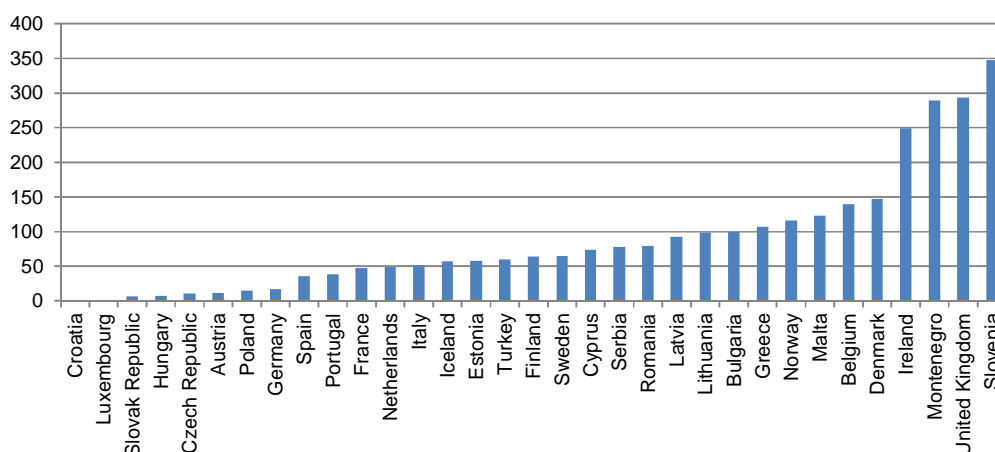
Implications

Having made that choice there are some implications as not all countries are effected equally. We conducted an analysis of the variance between these indexes to find out the effect.

The results show that some countries (Croatia, Luxemburg, Slovakia etc.) have very low variance between the indexes. This means that for these countries it does not make a difference which of the indexes are used.

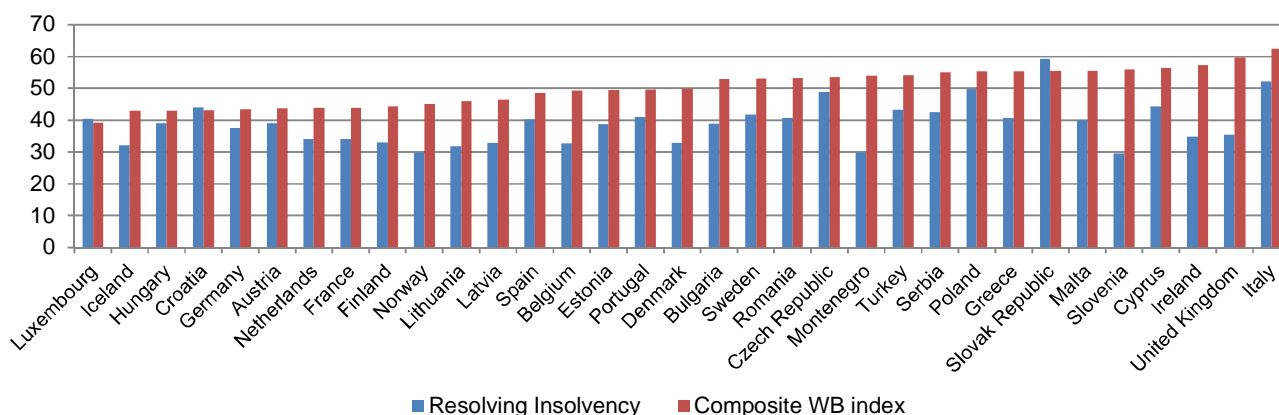
However, for others the reverse is true (Slovenia, UK, Belgium as *demonstrated earlier*, etc.)

Variance between indexes



This in itself is to be expected and does not discredit the earlier selection process. What it does however, say is that in those countries with high variance one should be aware of the fact that the underlying indicators differ and are not as linear as in others.

The graph below gives an example of difference in the two indexes under consideration:



Annex V: Interview reports

A.V.1 Specific Questionnaire for Credit Scoring Bureaus

The special survey was conducted with the help of FEBIS, who distributed it to their members. By the end of the study we received a total of 11 responses from 10 different countries.

1) Could you tell us the name of your organisation? The country in which you operate? The main focus of your activities?

2) Could you list any other Credit Scoring Bureaus that operate in your country?

We have used this information to ensure that the list in Annex III was as complete as possible

3) Are Credit Scoring Bureaus (such as yourself) regulated in your country? If so how? What is the regulatory framework?

We have used this information to ensure that the overview was as complete as possible and used it in section 5.2.1

4) From what sources do you gather the information on companies? What is the framework how you obtain such information (*licencing, public etc.*)? Do you have any particular issues in terms of acquiring the right/ accurate information?

We have used this information to ensure that the overview was as complete as possible and used it in section 5.2.1

5) What public/private credit databases (*including those on repayment history*) exist in your country (please list if possible)? What kind of information do they contain?

We have used this information to ensure that the overview was as complete as possible and used it in section 5.2.2 as well as to complete the list in Annex III

6) Does an entrepreneur get deleted from public/private credit database after discharge? If so : What rules with regard to deleting debtors from databases exist? Does this also apply to other databases (*eg. internal databases in your institute or banks*)

We have used this information to ensure that the overview was as complete as possible and used it in section 5.2.2 and 5.3

7) How do you deal with “struggling” companies? How do you deal with an entrepreneur that is restarting after a bankruptcy?

All respondents that did answer, stated that a struggling company is dealt with quantitatively by the model and depends on the configuration of that model. While in terms of restarting after bankruptcy all responses were of a fresh restart, often mentioning that if a company restarted under a different name there would be no way to trace it (except by its management said one respondent).

8) How do your operational processes differ from the legislative requirements?

All respondents answered that there is no difference.

9) Is there any area where you would see the need for more/less EU involvement? If so what and why?

The main responses were:

- Improve access to information (especially micro enterprise)
- Improve quantity and detail of information that is available (especially on micro enterprise)
- Promote the benefits and usefulness of PCSBs

A.V.2 Interviews

On top of the specific survey for PSCBs we conducted two interviews with PCSBs that are included below.

Ellisphere interview 25.03.2014

Could you explain more about your credit scoring activities?

1. General

Ellisphere (<http://www.ellisphere.com/>) scores and follows all registered entities in France & Monaco (over 7.5 million). 49% of these scores are on sole traders, while 21% is on unlimited companies.

The credit scores and risk information is available to only paying customers. Its clients are diverse and also include Banks and FS institutions that use the scoring for benchmarks and other non-direct scoring activities (since Basel III prevents them from doing so).

When a company is being scored it is often contacted to provide more information for a better quality of the score. In exchange Ellisphere has started a “transparency chart” that in exchange for information gives the enterprise/ entrepreneur his/her own scoring. The initiative has been in operations for 4-5 years and also works to explain the benefit and value of credit scoring for companies. In this way each year around 10 000 companies are contacted.

All companies are given a score by a model that is fed with a multiple of data sources. If client asks for a specific company more detailed information can be gathered beyond the standard financial analysis.

The company is audited and each three years its credit scoring model is also audited, to guarantee quality and that clients are not being deceived.

2. What is the competitive environment in the sector in your country?

There are three main private actors on credit scoring and risk information reports markets: Ellisphere, Altares and Creditsafe, and some less significant players.

Some other competitors are present on the business report and public sector information markets:

- société.com: information partly distributed for free, since its model is financed by advertising and based on development of partnerships,
- Infogreffe: an EIG, belonging to the Clerks of local Business Courts, which has the monopoly of distributing business register data and acts as:
 - web distributor on behalf of the Clerks of local Business Courts,
 - technical operator of INPI (National Institute of Industrial Property), which is in charge of the French National Business Register.

The Banque de France (French National Bank) is the only depositor of credit payment histories (unique system to France). In this way such information is only shared between banks, but nobody else.

The Banque de France also makes credit scores & credit ratings, but on the biggest 750 000 companies in France.

Registered Credit Rating Agencies are not really competitors, since they assess a very small number of French entities (about 350). But they could of course become one of them.

The total French solvency and scoring markets is estimated at 200 M€ a year.

The barrier to entry is mainly the investment cost in a global and exhaustive database of French companies (IT costs, infrastructure, management, data procurement (public sector information and private data)).

There is no licence system and no legal constraints on this scoring market preventing new entrants to develop business.

3. Your focus (size of companies under investigation, sectors focus etc)

distinguishes five business populations, each with several models specific to different sectors:

- sole traders (~ 3,700,000) 49%
- unlimited companies (~ 1,600,000) 21%
- associations (~ 670,000) 9%
- limited companies: Joint Stock Companies, Simplified Joint Stock Companies, Private Limited Companies with balance sheets (~ 1,000,000) 14%
- recent companies or not subject to balance sheets filing (~ 530,000) 7%

4. Are the scorings publicly available?

No, only to paying customers, or companies participating in “transparency Chart”

5. Are Credit Scoring Bureaus (such as yourself) regulated in your country? If so how? What is the regulatory framework?

- Scoring entities are not specially regulated in France.
- We used to be an ECAI (External Credit Assessment Institution) under Basel II till the 31st of December 2013.
- The ECAI recognition (on a voluntary basis) and the associated guidelines used to be the only available “regulation” for scoring entities.
- We got the ECAI recognition in 2007 from the French National Competent Authority, in charge of banks’ supervision.
- But we have automatically “lost” this recognition since Basel III, ie the CRR (Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012) provides that :
- “external credit assessment institution’ or ‘ECAI’ means a credit rating agency that is registered or certified in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies or a central bank issuing credit ratings which are exempt from the application of Regulation (EC) No 1060/2009”.
- Practically speaking, there is no more European or French “regulatory framework”, even on a voluntary basis, for scoring entities.

6. What are the technical criteria when assessing the creditworthiness of entrepreneurs?

A model of financial analysis is run and based on a algorithm updates itself constantly with new information.

7. From what sources do you gather the information on companies?

The information is received from multiple sources (see chart below). Most of the sources have a licensing fee that then allows for updates as they come in.

France is unique in this way due to its vast information available at affordable prices.

8. What public/private credit databases exist in your country? What kind of information do they contain?

Only reside with Banque de France and are not available to private providers

9. What in your view is the main role of Credit Scoring Bureaus?

- Scoring entities help access to finance of Mid-Cap and SMEs by proposing them tools to manage their credit and cash policy.
- To know more on its commercial relations (prospects, customers, suppliers) enables a company to pilot more efficiently its own finances.
- About 10 000 companies buy business and scoring information from Ellisphere in order to organize their own credit management policy.
- An entity which is badly scored is clearly affected by this policy but its supplier, also a company, may want to know if it will be paid. And as a customer, a company may want to know what the economic situation of its suppliers is.
- Moreover, knowing its own score and understanding how it has been calculated may also help SMEs to negotiate with their banks or other financing solutions.
- Most of the largest companies (interim, utilities ...) in France buy information and scoring computation from Ellisphere in order to access up to date information and manage easily their credit policy. Our score is often used as a “filter” for credit allocation to “well scored” companies and for credit decisions of low amounts.
- In the case of a company having a “bad” score or of an important credit to be granted, scoring systems are usually replaced by a human decision.
- It is important to note that a “bad” score doesn’t necessarily justify to stop granting a credit but instead to enhance the risk monitoring.
- Some of the largest banks, insurers, factors and financial institutions in France are customers of Ellisphere. Either they use our scoring in their own internal model or for benchmarking their own score.

In terms of prevention and second chance

10. How do you deal with “struggling” companies?

- The score is automatically updated and is a continuous process that takes into account many factors (including legal decisions).
- They can also contribute to the calculation of their score by filing us their last annual accounts (if not available from the Business Register) or main figures, on a confidential basis if required.

11. How do you deal with an entrepreneur that is restarting after a bankruptcy?

If a company goes bankrupt its score is suspended. If the entrepreneur restarts afterwards a new score is allocated. A previous bankruptcy, restructuring and other legal proceedings have a negative (soft) effect on the score (have particular indicators built into the model). There is evidence that a previous bankruptcy increases the risk of future bankruptcy or business failure. In France this is the prevailing “school”.

12. Does an entrepreneur get deleted from public/private credit database after discharge? If so : What rules with regard to deleting debtors from databases exist? How do they get in/get out of the database?

A decree, published in the Official Gazette in 2013/09, requires the Banque de France (French National Bank) to stop using the special code dedicated to entrepreneurs who have had one bankruptcy since less than 3 years.

It also modifies the duration taken into account since 3 years are now 5 years.

But please note that credit information from the Banque de France are available to banks, some credit insurers and the concerned entrepreneur only. Private companies like Ellisphere cannot access this information.

13. Is there any area where you would see the need for more/less EU involvement? If so what and why?

- The main difficulty we have is to manage contradictory (in terms of consequences) EU regulations.
- At present time, a lot of initiatives, in France but also from the EU Commission, aim to make access to finance easier for SMEs since it is more difficult for them to get credit from the banks of Basel III capital requirements.
- Since credit scoring is helping companies to manage their credit and cash policy, it contributes to access to finance.
- Please see also the following document from the EU Commission, especially from page 125 (we have contributed to the survey).
- http://ec.europa.eu/internal_market/economic_analysis/docs/efsir/130425_efsir-2012_en.pdf
- To make a reliable score makes it mandatory to access information, in particular financial information.
- But Company Law Directives, in particular the 2013/34 directive regarding annual accounts, enable Member States to allow micro-entities not to publish their accounts anymore and **reduce the number of information to be filed by small companies.**
- Credit assessments available today are credit ratings, very regulated with the EU Regulation 10/2009, and credit scoring, not regulated at all.
- Scoring is mainly used by SMEs for their daily credit management and rating is necessary for being listed etc. or reassure investors.
- If we consider that Ellisphere provides a score on 7,5 million entities and that about 350 French companies have a rating, it seems to us necessary to **develop some minimum standards for scoring.**

Informa interview 25.03.2014

Could you explain more about your credit scoring activities?

1. General

Informa (<http://www.informa.es/en/>) has been in operation for 20 years and is based in Spain, but also covers Portugal. It follows and scores all companies in those two countries (about 3 million in Spain)

The main focus of the company is:

- Collect information on companies (including credit repayment history), compile it into a database & sell the information to clients = *credit database*
- Conduct company analysis and risk valuation to sell to clients, on either a sectoral or individual company level = *credit scoring*

2. What is the competitive environment in the sector in your country?

In Spain there are 3 other companies that operate on a similar basis like Informa.

3. Your focus (size of companies under investigation, sectors focus etc)

- All companies in Spain & Portugal are covered.

- In Spain around 3 million companies are followed. Of which 1.2million are corporations and 1.8 million are sole traders.
- Sole proprietor is not required in Spain or Portugal to publish its financial figures.

4. *Are the scorings publicly available?*

No, only to paying customers.

5. *Are Credit Scoring Bureaus (such as yourself) regulated in your country? If so how? What is the regulatory framework?*

Scoring entities are not specially regulated in Spain or Portugal.

The Portuguese branch used to be an ECAI (External Credit Assessment Institution) under Basel II till the 31st of December 2013.

6. *What are the technical criteria when assessing the creditworthiness of entrepreneurs?*

- A quantitative financial analytical model conducts the scoring. It is calibrated with lots of ratio's financial analysis & other "soft" indicators. These can include legal procedures and repayment history.
- The whole model is fed by the internal database, that is unique in Spain and Portugal (due to the difficulty of acquiring the data).

7. *From what sources do you gather the information on companies?*

- Information is very difficult to acquire in both Spain and Portugal and when it is available it is very expensive. The devolved nature of Spain means that each region keeps its own data. Informa needs to buy each of these information separately from multiple collecting institute and then standardize it to gather a national database.
- Since sole traders and small companies are exempt from the requirement to provide financial information a large part of the economy is simply "invisible".
- **Spain has a cultural problem with reporting bankruptcies.** Last year there were only 900 bankruptcies recorded, which is a fraction of the reality. The common practice is to simply come to an informal agreement with the creditors & then to close the company down. In this way thousands of companies simply "disappear" each year. Informa has developed a system to find such disappearances and label them in their database as essentially bankrupt.

8. *What public/private credit databases exist in your country? What kind of information do they contain?*

- Besides Informa there are 3 other private companies that compile information and sell it onwards to paying clients.
- The information includes financial data, court decisions, but also credit repayment histories.

In terms of prevention and second chance

9. *How do you deal with "struggling" companies?*

The score is automatically updated and is a continuous process that takes into account many factors (including legal decisions).

10. *How do you deal with an entrepreneur that is restarting after a bankruptcy?*

Once any legal process has been conducted the impacts are considered in the credit scoring for the next 2 years. However, if the entrepreneur decides to restart under a new company with a different name, completely new credit scoring has to be conducted, since in Spain private credit repayment histories are not publicly available.

11. *Is there any area where you would see the need for more/less EU involvement? If so what and why?*

- Need for minimum standardization. Not full regulation & not to the same extent as credit rating agencies, but some sort of accreditation such as the ECAI system would be welcomed. This would formalize the industry, help to build more trust and allow to sell to more clients.
- Need to improve data availability and its presentation. Until 2013 in Spain legal decisions were not published online, but only on the notice boards of each court. Gathering such information has been very costly, erratic and time consuming. More and better information provision would be very and benefit companies, entrepreneurs, investors and legislators alike.

Annex VI: Summarised country reports

A separate document was provided for the 33 summarised country reports.



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