

Debt relief and its impact on credit companies within the Czech Republic

Bachelor thesis

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Abstract

This bachelor thesis investigates economically-legal issue debt relief, its form and resulting consequences of this concept on both debtors and creditors. As a result, this study completes a picture of debt relief in the context of the Czech legal system using historical context and current state of things. Obtained information are therefore used in practical part where debt relief in practice is presented. Its actual impact on both debtors and creditors and their managerial decisions is discussed and supported by real figures and interview with risk management specialist. The conclusion of this study is then what is the impact of debt relief as a legal and economical issue.

Keywords

Debt relief, insolvency, credit risk management

Abstrakt

Tato bakalářská práce blíže zkoumá ekonomicko-právní institut oddlužení, jeho formu a vyplývající následky tohoto konceptu jak na dlužníky, tak na věřitele. Výsledkem tohoto zkoumání je ucelený obraz oddlužení v kontextu českého právního systému s využitím zasazení do historického kontextu a současného stavu věcí. Získané informace jsou pak použity v praktické části práce, ve které je oddlužení ukázáno v praxi. Jeho vlastní dopad na dlužníky a věřitele, manažerská rozhodnutí jsou diskutovány, podloženy daty získanými z relevantních zdrojů a krátkým interview se specialistou řízení rizik. Závěrem této práce je pak zhodnocení vlastního dopadu tohoto právního a ekonomického konceptu.

Klíčová slova

Oddlužení, insolvence, řízení úvěrových rizik

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1 INTRODUCTION

The topic of this thesis is a debt relief as an legally-economical concept with growing “popularity” among the citizens in the Czech Republic. It has started in the ancient times, when people found out they may borrow money to get things they needed or wanted. At the same time, other people who actually had this money started to think of lending it as a form of business. And that is when the roots for my topic were set. Throughout the history, this so-called credit system grown in its importance and ruined or made better enormous number of lives. As a consequence, the concept of debt relief, which could be perceived as a process following personal bankruptcy, was gradually invented.

Since its implementation into the Czech legal system 10 years ago, its importance has grown a lot. The own concept has already played and will play a crucial role for many people and households in the Czech Republic, since it may be perceived as a possible “fresh start” for their lives. However, a restart of their economical lives also has an impact on people they borrow the money from, creditors. With still quite recent Great Recession, which was a result of living on debt, and its impact being felt even today, I believe it is a very topical issue.

Having this knowledge, and because I am interested in the topic, I decided it would be interesting to find out more about this concept. What is the actual process, its impact, and whether it is a real economical threat for creditors.

2 GOALS AND METHODOLOGY

2.1. Goals

As a main goal of this thesis, research of processes of debt relief and evaluation of its impact is set. In the theoretical part, this concept as a whole with all its aspects will be researched. The goal of this part is to get a complex theoretical knowledge on this topic to be able to continue into practical part of this thesis. In practical part, one of the goals is to show how debt relief works in reality. Examples of debt relief in practice will be counted to provide a real image on how the whole process works. Another idea also is to show what impact this process has on debtors. This also will be discussed. And the main goal of this thesis then is to find out, what debt relief really means to credit companies. Answers on questions like whether they see it as an actual threat or not and what kinds of protection might be used for preventing lending money to a potentially problematic debtor.

2.2. Methodology and material

As a main source for the theoretical part, both domestic and foreign scientific literature and online sources will be used. In this part of the thesis, descriptive method will be used to show what debt relief actually is. The first part will consist of explanation of few important terms that are necessary for correct understanding of the text. It will be followed by a short historical excursion of this concept in our region to give an insight on what was the development like. A short description of debt relief in the United States of America will be a part of this thesis as well, since its position in their legal system was an inspiration for our model, and many tools they created are used in our today's system. Germany, as a neighboring country with similar history of this concept, will be mentioned as well. Then, a description method will be used again to give a complete picture of what debt relief really is in legal context. Czech legal documents such as Act No. 182/2006 Coll., also known as the Insolvency Act, as well as magazines relevant to this topic such as *Právní Rozhledy* will be the main source for this part.

As it was already mentioned, the real impact of debt relief on both debtors and creditors will be shown in practical part. Using statistical data obtained at Czech Credit Bureau or portal justice.cz, actual numbers connected with this topic will be presented in form of tables. To give even better insight on how the process looks like in practice, two case studies in form of examples of two imaginary debtors will follow. Calculations based on relevant laws will be included, as well as

actual impact on debtors. Afterwards, the perception of debt relief by creditors will be discussed. For cause of this thesis, banks and credit companies such Home Credit a.s. will be used as relevant examples of creditors. Methods of practical protection against problematic debtors and providing loans to those will be presented with a use of scientific literature. Information obtained during consultations with a credit risk management specialist will be one of the tools to show what are the results of these methods. And as a valuable part of practical part of this thesis, a short interview with the same specialist will be presented. It will give answers from practice to questions critical for the purpose of this thesis.

Discussion on what is the reality in comparison with my current assumptions, expectations and knowledge about debt relief and its impact will be one of the last two parts. And as a final part, conclusion on whether the goals of this bachelor thesis were or were not met will be discussed.

3 TERMINOLOGY

Throughout this thesis, few important terms which should be briefly describe at first will be used. Those are essential to understanding the topic as a whole.

Debtor

Debtor is, in our case, a natural person who has financial obligations towards other natural person or a legal entity. This person must not have debts resulting from their entrepreneurship, according to Act No. 182/2006 Coll. However, this fact has slightly changed with new legislative, which will be discussed later in the thesis.

Creditor

Actual definition of according to Collins English Dictionary says that creditor is a person or commercial enterprise to whom money is owed. For the purpose of this thesis, especially in its later parts, creditor will be basically perceived as a bank or a credit company.

Insolvency

In legal terms, the insolvency means “an incapacity to pay debts upon the date when they become due in the ordinary course of business; the condition of an individual whose property and assets are inadequate to discharge the person's debts”. (thefreedictionary.com)

Debt Relief

According to Investopedia.com, debt relief is “the reorganization of debt in any shape or form, so as to provide the indebted party with a measure of relief, either fully or partially, from a huge debt burden. Debt relief can take a number of forms: reducing the outstanding principal amount (either partly or fully), lowering the interest rate on loans due, extending the term of the loan and so on.”

It is supposed to give a debtor possibility to a “fresh start”, while it slightly prefers social to economical aspects in terms of dealing with bankruptcy. However, the economical aspect in the sense of being able to return into economical life without any financial obligations towards creditors is the main reason for applying for debt relief. (Kavan, *Právní rozhledy* 12/2008, s 434)

4 HISTORY

4.1. Short introduction

In nowadays world, the situation of falling into a “debt spiral” and to a state where an individual is not able to pay their debts, is not very rare. Truth is though, that it is not about the state our society is in these days. Problems with repaying debts had occurred way in the history and ever since many were looking to find the most acceptable solution to these hopeless situations.

In this chapter, a short history of the development of bankruptcy law in our region is presented. It is then followed with a history of the same legal issue in the United States and Germany. The reason to look at historical development of bankruptcy law in these two countries is their importance and impact on current position on bankruptcy and debt relief in the Czech Republic.

4.2. Austria-Hungary to the Czech Republic

The history of legally dealing with indebtedness has its roots back in ancient Rome, which set the basics for the legal systems we know today. However, the first actual legal code in which bankruptcy was mentioned was adopted in the Austrian Monarchy in 1781 in the “Josephine” and it was called the Bankruptcy Regulations. (fasst.cz, online) In 1868 this code was replaced by the more modern bankruptcy Act no. 1/1869 in Reichsgesetzblatt (hereinafter referred to as the „RGBI“, a source of law for Cisleithania-a north-eastern part of the Austria-Hungary) and was valid until the World War I. The whole process consisted of two parts. In the first one –opening– all the conditions of claiming the bankruptcy were discussed. The second one was the insolvency proceeding itself. In the second phase, the property in question was divested from a debtor and entrusted to a trustee in bankruptcy. Subsequently, the duties of record-keeping and giving information were given to a debtor. Important was the committee of creditors who were an obligatory component of a proceedings.

A new development in the history of bankruptcy law came in 1914 with a emperor’s regulation no. 337/1914 RGBI, which was later accepted and adopted by Czechoslovakia in the Act no. 11/1918 Coll. Therefore the bankruptcy law was officially a part of the Czechoslovak legal system.

The issues of bankruptcy were later implemented into Czech law by the Act no. 64/1931 Coll., where new orders of bankruptcy, compensatory and objector, appeared for the first time. As a

consequence of this law, if a debtor was not able to repay the debts, he or she was faced three legal possibilities of a solving the situation: a out-of-court settlement with creditors, at court settlement, or inflicting a bankruptcy. The main goal of the last two was then at least a partial (but evenly split) satisfaction of the creditors. The debtor was relieved of their debts, did not lose property, and was allowed to run his finances. This was a big step ahead in the topic of this thesis and at that time, it was even very modern legal solution. It has given grounds to todays bankruptcy solving, while some elements are still used within this issues. (Frelichová, 2008)

Another changes were closely connected with a change of reign in our country. An infamous year 1948 later resulted in cancellation of the Act no. 64/1931 Coll. without being adequately replaced and only being followed by the Act no. 142/1950 Coll.. Both political and social situation, that occurred in our country and lasted for more than 40 years, caused that no insolvency law was really needed anymore.

After 1989 when the so-called “Velvet Revolution” took place, a private entrepreneurship and a changeover to a market economy were finally implemented into Czechoslovak economical system. It naturally led to a situation where a bankruptcy law was needed again. This situation was initially solved with the Act no. 328/1991 Coll., which was issued in 1991 and regulated bankruptcy and compensation. It was not enough, though. Free economy, boom in bank sector, excitement of residents or increasing availability to get a loan and resulting living on debt, those were the reasons for a growing problem. The then state of things needed a new and more complex legal solution. And that is when lawmakers created the Act No. 182/2006 Coll. Bankruptcy and Settlement (hereinafter referred to as the “Insolvency Act”) which is still in effect even today, although it is expected to undergo a change with an amendment called Act no. 294/2013 Coll. The Insolvency Act itself first came to effect on the 1st January 2008. That also is when the definition of “debt relief” was used for the first time. The amendment then revised a bankruptcy law with changes like a debt relief of entrepreneurs, which will be discussed later in the thesis. (Kozák, online)

Ever since the Czechs established their own country, the trend of Czech households living on debt started to increase and today the bankruptcy is a real and quite common part of their lives.

4.3. The United States of America

The reason to discuss the history of bankruptcy in the USA is that the development which this legal issue has undergone overseas is interesting, important for the whole world's development of bankruptcy and for comparison. Many concepts and tools we use in our system are based on theirs.

On the example of the USA, we can briefly point out the roots of falling into indebtedness so huge that it results into a bankruptcy. Debt relief or bankruptcy, as we know it today, might have its origins in the United States, and its way to the current system had been long and defined by historical context. They soon started to rely on so-called "credit system", which could be briefly described as "a set of rules and organizations involved in the process of making loans on a commercial basis". (bc.edu, online) For the purpose of this thesis, few points of their history are important. One of them is the Bankruptcy Act of 1898, which was in effect for another 80 years. The office of trustee in bankruptcy was established as well, which is used even in our nowadays' insolvency system. (rib.uscourts.gov, online) With the Bankruptcy Reform Act of 1978 which superseded the 1898 act, bankruptcy courts (analogy to our insolvency courts in a sense of way) were created. In the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, an amendment to the 1978 act, another interesting changes were made such as making credit counseling be a condition for a debt relief, financial management training being a requirement to obtain discharge, or recognized international insolvency cases, according to

4.3.1. Present day form of bankruptcy law in the USA

In the USA, the form of personal bankruptcy is nowadays different to the one we use in the Czech Republic. The difference between the two mentioned countries is especially in the negative social effect and the consequences it has on the perception of debtor in the future when talking about credit companies. The reason is more restrictive form of bankruptcy in the US, since the debtor has a tough time getting another loan within next 10 years after the debt relief. In the Czech Republic the debtor whose debts were paid under the terms of bankruptcy law is after 5 years perceived by the credit companies as able to pay the installments on a regular basis again.

The source of bankruptcy law in the United States Code is Title 11 of the United States Code (hereinafter referred to as the „US Bankruptcy Code“). This code is divided into 9 chapters where

4 of them deal with the initial process of filing a motion for debt relief and other general issues. Remaining five chapters deal with the real impact in the sense of possible solutions of falling into bankruptcy. (Raban, 2002, p.429)

According to Raban, Chapter 13 of the US Bankruptcy Code is the most similar to the Czech form of personal bankruptcy respectively debt relief. The bankruptcy court provides an individual the opportunity to repay debts, reorganize their finances and financial affairs, and return to a “normal” life. It is though restricted only to individuals with regular income and unsecured debts of less than \$383,175.00, and secured debts of less than \$1,149,525.00, which is different to our system. Interesting facts are that the debtor must participate in 180 days long authorized financial consultancy course. Then there is so-called hardship discharge which gives a debtor opportunity of relief of rest of the debt in cases of inability to pay their debts due to injury after paying part of their debts to creditors. (White, online)

4.4. Germany

In this part, the history of German bankruptcy law will be described just very briefly, while it is important just for comparison in this thesis.

German bankruptcy law has its roots in an old bankruptcy code of 1877. The most important changes occurred in 1978, when German lawmakers have begun recodification. Reasons were oil crisis and subsequent increased amount of bankruptcies. Main source of ideas was American legislation.

In 1994 Insolvenzordnung (hereinafter referred to as „IO“) was accepted and has become effective in 1999. Since this code became active quite late comparing to codes in other countries in the region, it draw inspiration from all of them as well. According to Raban (2008), it might be perceived as more sophisticated. Main points of IO which differ to our codification are for instance that even an impending insolvency is a reason for bankruptcy, or relief of rest of the debt when proving acceptable financial behavior over the course of 7 years.

5 DEBT RELIEF IN THE CZECH REPUBLIC

5.1. What is debt relief and who may apply

As already mentioned before, debt relief is some kind of reorganization of debt. It provides individual a possibility to relief their debt when it is already impossible to be fully repaid. It means that after agreement of a court, a debtor will be partially forgiven their debts. The rest of them then must be paid.

It is rather new concept in the Czech legal system, which has been revised in recent times. It must be said that it is basically an opposite to what reorganization means for entrepreneurs. Reorganization in this context means an agreement of debtor (entrepreneur) with creditors. Debt relief, on the other hand, is usually a choice of a debtor – natural person or a legal entity, whose debts have not resulted from entrepreneurship or whose debts have resulted from their entrepreneurship, and creditors accept their debt relief application. (Janda, 2013)

In the chapter History, development of the problem of bankruptcy and debt relief was described. Nowadays, the code we use for dealing with occurred insolvency problems is the Insolvency Act.

In the Insolvency Act, debt relief and from whom may the application be made is stated in Title 5 Debt relief (§ 389-418) as follows:

1. Debtor may apply to insolvency court for a debt relief as a solution for their bankruptcy if the debtor is a) a legal entity who is according to law not perceived as an entrepreneur and their debts have not resulted from entrepreneurship; b) a natural person whose debts have not resulted from entrepreneurship.

2. A debt from entrepreneurship pervert the solution of debtors bankruptcy or an impending bankruptcy if a) a creditor of certain debt agrees or b) a debt of a creditor, which has remained unpaid after insolvency process, is in question or c) a debt of a secured creditor is in question.

3. No other person than the debtor is permitted to apply for debt relief.

5.2. Causes of unpayable debts of individuals

Obviously, insolvency results from debts which become impossible for debtor to pay for on their own. As stated in the chapter History, after the Velvet Revolution and with the arrival of free trade, Czechs started using credit system in large extent. Two types of insolvency resulted of this situation.

Insolvency as an inability to pay debts

This form means that a debtor has financial obligations that have passed a limit of 30 days delay of due date and is not able to pay for them. Debtor must also owe to more than one creditor. In case this condition is not met, creditor may apply their right to prosecute their claim through execution process. (Kozák, 2008)

Overindebttness

As stated by Kozák, in this case, a debtor must again meet a condition of having more than one creditor. Total sum of debtor's claims must then be higher than total value of their property. This form occurs especially among entrepreneurs who may also apply for debt relief according to new legislative mentioned in theoretical part.

5.3. Debt relief procedure

This part focuses on the process of debt relief as a whole. It all starts with the application which may be done when all the legal requirements mentioned above are met.

5.3.1. Application

According to § 136 subsection 3, Insolvency Act, The debtor uses an insolvency proposal to propose a debt relief as a solution of their insolvency at first. If the insolvency proceedings is to be initiated, it is published in the insolvency index in form of a public notice. This moment is important for creditors, since they must apply for their claims for next 30 days since the resolution of bankruptcy is made. The same period is set for debtor to apply for a debt relief in case creditors propose for debtors insolvency first. However, debtor must be noticed by an insolvency court that this situation occurred.

Application for debt relief must include designation of a debtor. Information about their income in upcoming 5 years as well as information about their income in past 3 years are required. So is list of property, as well as obligations and debts and approval of creditor that the repayment during the debt relief period will be higher than 30% of their claim. (Janda, 2013)

5.3.2. Approving the application

At this stage, the acceptance of debt relief is not up to the court but it depends on a agreement of vote of all creditors involved in particular case. They vote works on a principle of a simple majority of unsecured debtors. The result of a vote is important for the insolvency court, which is the last one to give the resolution whether to approve or reject the application.

The resolution of approving the application is important while it includes all the important information necessary for following steps. That means for instance a form of debt relief, defining assets to be converted into money, payment schedule or insolvency trustee. After the resolution of approving the debt relief it is again published in the insolvency index which makes the debt relief effective. (justice.cz, online)

5.3.3. Forms of debt relief

As it is stated in the Insolvency Act, there are two forms of debt relief in the Czech legal system:

Selling debtor's property

The first possible solution of debt relief is selling debtor's property in question at the moment. That is therefore everything creditors will get in return for their claims. However, it does not include any assets which the debtor gains in the future or even within the process of debt relief. It also excludes a property gained as a heritage or a gift. This property may later be used as an extra instalment.

In this form, after the resolution of the debt relief, the insolvency court must designate who is an insolvency trustee, their commission and what the compensation of their expenses will be. It also defines what belongs to debtor's assets according to the date of the resolution. Defining unsecured creditors who accepted compensation of less than 30% of their obligations is then the last part of

this process. It is the much less used method of debt relief solution – just 3% of the approved debt reliefs are solved using this for as it will be apparent from the tables of the practical part of this thesis. (Insolvency Act, 2011)

Repayment schedule

This form of dealing with debt relief is the most used one with almost 96.5% of all cases according to justice.cz. It might be perceived as the easier solution and debtors actually think of it that way. The reason is simple. With this form, debtor does not have to lose his property which will not be impounded and sold under the insolvency proceedings. Using this form, debtor is obliged to repay the debts only to unsecured creditors over the course of 5 years. The total amount of compensation must be at least 30 % again as to what Strnad and Holešínský discuss (2008).

According to Mgr. Rostislav Krhut (Insolvency Conference, 2015), a deputy chairman of the Regional Court of Ostrava, it is important to point out the fact that all of debtor's income during the period of debt relief is in question. Another very important fact Mgr. Krhut mentioned is that none of the property obtained by a debtor during the debt relief process is then part of repaying as an extra income. The only exclusions are an extra income e.g. in form of bonuses or a gift, which is then by legal authorities understood as a help from a third person. However, if a debtor makes another debts during this process and is imposed on with a execution, even the property he somehow manages to obtain may be in question. (Insolvency Act)

5.3.4. Impact of changes according to the new legislative (2014) and discussion on change of 30% limit for repayment schedule form

An important change came in 2014, when an amendment to the Insolvency Act, the Act.294/2013 came in effect. The main difference is that even an entrepreneur whose debts resulted from entrepreneurship may apply for debt relief these days. However, it is restricted with an acceptance of creditors, which is quite limiting. On the other hand, in some cases it might be the only possibility for creditors to get at least part of their obligations back. (epravo.cz, online)

It is obvious that because of loses creditors usually have from debt relief, they will not be willing to accept the application on many occasions. It gives a new chance to entrepreneurs to recover from their debts.

Another significant change for debtor came with a regulation of § 414 of the Insolvency Act. In the first edition was stated: “If a debtor fulfills all requirements of form of approved debt relief correctly and on time, insolvency court then gives a resolution on debtor’s relief of repaying obligations involved in debt relief process to extent to which those were not met yet. The court does so only after debtors’ proposal.” It often resulted in debtors not closing their debt relief process while they forgot to apply for cancellation of the process. The last sentence of this regulation: “The court does so only after debtors’ proposal.” was taken away of the Act, which made the process of debt relief be automatically cancelled after repaying the set repayments amount.

According to a lawyer Mgr. Michal Pokorný, who specializes in this topic, there is a growing discussion on whether to remove the limit of minimal repaying of 30% . That would mean another growth in losses for creditors. But even though this topic is just hypothetical, I believe it will be interesting to find out how important role would it play for credit companies. This question will be answered in the interview in the practical part of the thesis.

6 DEBT RELIEF IN PRACTICE

The purpose of this part is to show how debt relief looks in practice. As a result, its impact on debtors, creditors and managerial decisions of companies providing loans will be shown.

To give an insight on how many cases of debt relief and insolvencies as a whole have occurred in the Czech Republic in recent years may be given, following tables are used.

Insolvency and debt relief in numbers - 2nd quarter of 2013			
Insolvency applications	Insolvency applications	Insolvency applications connected with debt relief	7 538
		Insolvency applications in total	9 330
	Insolvency applied by a debtor	Insolvencies applied by a debtor connected with debt relief application	7 528
		Insolvencies applied by a debtor in total	8 426
	Insolvency applied by a creditor	Insolvencies applied by a creditor connected with debt relief application	0
		Insolvencies applied by a creditor in total	893
Debt relief	Accepted debt reliefs	Resolutions on accepting debt relief	5 467
	Approved debt reliefs	Resolutions on approving debt relief in form of selling debtor's property (according to a regulation § 402 section 5 Insolvency Act)	121
		Resolutions on approving debt relief in form of repayment schedule (according to a regulation § 402 section 5 Insolvency Act)	4 344

Figure 1 Insolvency and debt relief numbers in the Czech Republic, 2nd quarter of 2013 (own work, source of data: justice.cz)

Besides other interesting facts such as proportional part of insolvency applications connected with debt relief to insolvency applications in total, it is obvious that the method of repayment schedule is used in most of the cases. Selling debtor's property as a form of debt relief is in a great minority.

Insolvency and debt relief in numbers - 2nd quarter of 2014			
Insolvency applications	Insolvency applications	Insolvency applications connected with debt relief	7 851
		Insolvency applications in total	9 012
	Insolvency applied by a debtor	Insolvencies applied by a debtor connected with debt relief application	6 163
		Insolvencies applied by a debtor in total	6 613
	Insolvency applied by a creditor	Insolvencies applied by a creditor connected with debt relief application	0
		Insolvencies applied by a creditor in total	700
Debt relief	Accepted debt reliefs	Resolutions on accepting debt relief	6 332
	Approved debt reliefs	Resolutions on approving debt relief in form of selling debtor's property (according to a regulation § 402 section 5 Insolvency Act)	197
		Resolutions on approving debt relief in form of repayment schedule (according to a regulation § 402 section 5 Insolvency Act)	5 504

Figure 2 Insolvency and debt relief numbers in the Czech Republic, 2nd quarter of 2014 (own work, source of data: justice.cz)

When comparing these two tables, numbers of debt reliefs grew in the course of one year by 27.68%, which is a significant growth. Since the cases in the 2nd quarter of 2014 are already taken under the new legislative the growing figures, it might be influenced by changes mentioned above.

At the end of 2014 Czech Credit bureau stated that the final number of personal bankruptcies was 18,762 which is by 613 less than in 2013. This situation occurred for the first time since the Insolvency Act became effective. Number of applications in 2014 was 21,955 which is by 8,258 less than in previous year. (crif.cz, online)

To create a better image of debt relief numbers, I decided to use graphs. Therefore, the tables bellow represent a decomposition of information gained at justice.cz:

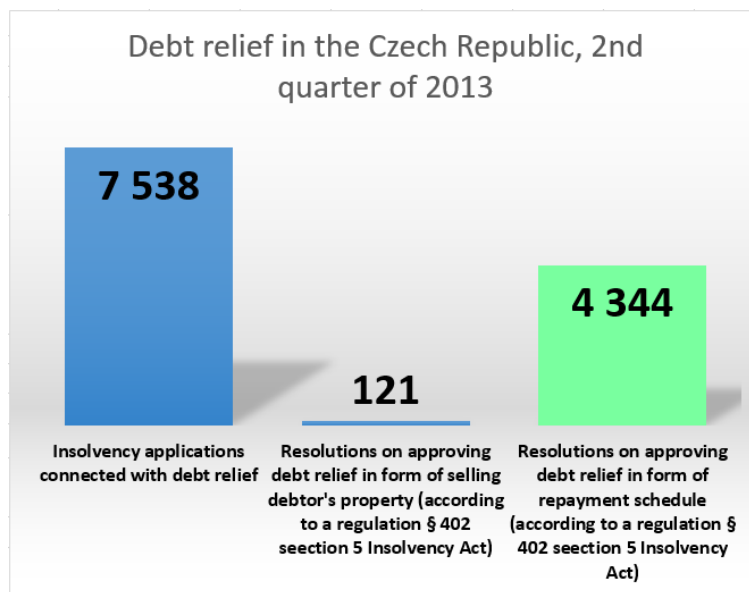


Figure 3 Debt relief in the Czech Republic - graph, 2nd quarter of 2013 (own work, source of data: justice.cz)

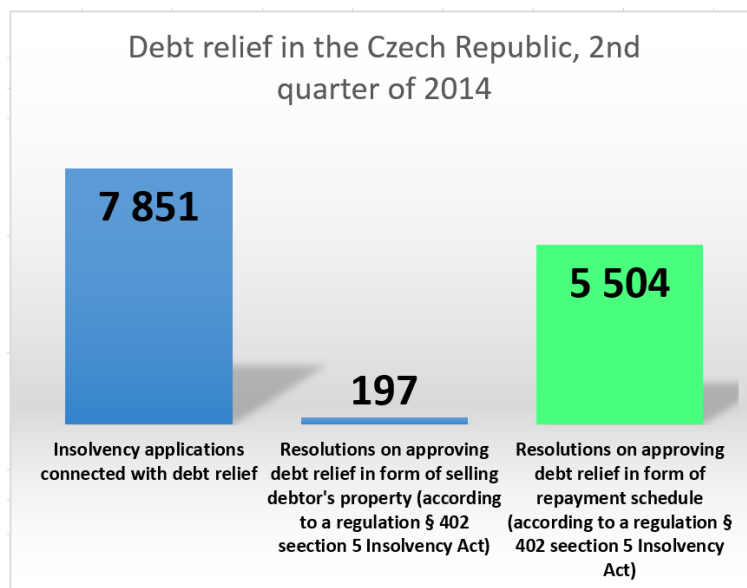


Figure 4 Debt relief in the Czech Republic - graph, 2nd quarter of 2014 (own work, source of data: justice.cz)

6.1. Selling debtors property in practice

As a less usual form of debt relief, selling debtors property is still important to mention. From a practical point of view, it is quite different.

It has already been mentioned that this form of debt relief will not be further discussed, while it is much less used and its impact is therefore much smaller. However, for creditors it might be an opportunity to minimize their losses in particular cases. To point out the difference between this method and a form of repayment schedule, an example of this method will be briefly presented, as well as an example of decision of creditors whether to accept debt relief in case of debts resulting from entrepreneurship or not.

6.1.1. Practical example of selling property in practice on an imaginary case

Suppose there is an entrepreneur Mr. Novak, whose financial situation becomes critical after his business stopped being profitable. He has own flat worth 1,500,000 CZK, a minivan worth 300,000 CZK which he got as a gift, and a small holiday cottage worth 800,000 CZK¹. His debts are worth 3,000,000 CZK. He does not want to lose his company and decides to deal with his indebtedness by applying for a debt relief in form of repayment schedule as an individual. A vote of all creditors involved in his case accepted his application even though his debts are results of entrepreneurship. However, they decided that debt relief will be processed in form of selling his property. The reason was that his expected incomes in the future are very low and therefore they will reduce their immediate losses this way.

In this method of debt relief process, a public auction on his property will be organized. Both his flat and a holiday cottage were sold only for 80% of their respective values, together for 1,840,000 CZK which makes the remaining debt of 1,160,000 CZK. This way creditors got at least some part of their claims back rather than relying on profitability of his questionable business.

Few days after finally satisfying creditors' needs and being debt relieved, Mr. Novak receives a small flat worth 1,000,000 CZK as a gift from a close friend as a help to new start. Now he is an

¹ All property's values are a product of own work inspired by real estate agency website: <http://nemovitosti-reality.hyperinzerce.cz/>.

owner of this property but it does not make any difference for creditors since it was not part of his property at the moment of debt relief approval and proceedings.

6.2. Repayment schedule in practice and its calculation

Calculation of an monthly instalment is the first step in creating a repayment schedule for debt relief. As a result we also get a final net monthly income of a debtor over the period of debt relief.

Monthly instalment calculation consists of a net income of a debtor. A net income is here understood as income repeated on regular basis. Besides regular wages from employment, it may also consist of other kinds of income such as pension, scholarships, sick pays, maternity pay and others according to § 299 Act no. 99/1963 Col. Code of civil procedure. Excluded of a net income calculation are one-time social benefits such as maternity grants. Housing benefits, benefits in times of material poverty, benefits according to the Act 108/2006 col., and benefits meant for a third person (foster benefits, etc.) are also excluded from this calculation. Minimum living wage of an individual and their set normative housing expenses are basis for calculation of amount of money which must not be taken away from them. (Act no. 595/2006 Coll.)

According to Mgr. Krhut, income in question is problematic even among judges and other relevant specialists. As mentioned in his presentation, in practice incomes such tips for waiters (even though these are usually not imposed with taxes in practice), income from author activities, entrepreneurship, or a tax bonuses are also included in debtor's income.

Due to inaccessibility of certain information for year 2016, a model using statistics in year 2015 will be used.

Calculation itself then looks as follows:

Net income of a debtor – Amounts that can not be forfeited (*Living wage + set normative housing expenses = 6,178.67 as for 2015 and following years, Nourished persons - 1,544.67 CZK / person and then round up, and others, according to Ministry of Labour and Social Affairs*) = **Final amount** rounded down to a full number divisible by 3. The result then equals **B** (base for instalment). With this results, following possibilities occur:

A) If $B > 9,268$ CZK, then everything over this amount will be deducted + additional $2/3$ of $9,268$ CZK ($6,178.67$ CZK) will also be deducted of BI

B) if $B < 9,268$ CZK, $2/3$ of BI will be deducted of BI

After calculating base for instalment, we must find out what the gross monthly instalment will look like. It is patterned on two possibilities mentioned above.

A) $6,178.67$ CZK + (BI – $9,268$ CZK)

B) $2/3$ of B

After deducting a gross monthly instalment of their income, we are able to calculate debtor's monthly income.

A) Amounts that can not be forfeited + $3,089$ CZK

B) Amounts that can not be forfeited + $1/3$ of B

Now it is necessary to calculate whether debtor is able to repay at least aforementioned 30% of their debts. Simple calculation includes following four steps:

- Gross monthly instalment – insolvency trustee's commission (900 CZK incl. VAT)
- If a debtor has a legal duty to maintain, we deduct the full amount of maintenance
- Final net monthly income is then multiplied by 60 ($5 * 12$ months)
- Deduction of claims beyond debtor's property (e.g. debt for maintenance) – full amount of these claims must be repaid.

Now it is decided whether debtor is or is not able to repay at least 30% of their debts to unsecured creditors, according to the Insolvency Act.

6.2.1. Practical example of repayment schedule on an “average debtor”

Suppose we create an “average debtor” Mr. Novak for year 2015. Mr. Novak is married, has one child, and is employed on a regular contract. Since Mr. Novak works as an employee, suppose he belongs into the first group of debtors mentioned in theoretical part of this thesis – those who are unable to pay their debts. He owes to multiple creditors and his debts are in total of 1,000,000 CZK. His average gross income is 26,467 CZK (average gross monthly income in the Czech Republic as for 2015, according to the Czech Statistical Office), of which we later calculate his net income. Mr. Novak then decides that he is not able to pay his debts so he applies for a debt relief. Suppose his application was accepted and approved and it is decided to use a method of a repayment schedule.

We start the whole example with simple calculation of Mr. Novak’s net monthly income.

Gross wage	26 467 CZK
Spouse	1
Children	1
Super-gross wage	35 466 CZK
Base amount for calculating tax	35 500 CZK
Tax before discounts	5 325 CZK
Tax discounts	2 070 CZK
Tax	-3 255 CZK
Tax discount on child	1 117 CZK
Social and health insurance (employee)	-2 913 CZK
Social and health insurance (employer)	-8 999 CZK
Final payment to state	-14 050 CZK
Net income	21 416 CZK

Figure 5 Net income of "average debtor", own work

His gross income makes a super-gross wage (gross income increased by social and health insurance paid by employer) of 35,466 CZK. This amount is rounded up to a number divisible by 100. Tax base before discounts is 5,325 CZK (15% of gross income increased by 9% for health insurance and 15% for social insurance). After a discount of 2,070 CZK (monthly discount on a tax payer) we get a tax of 3,255 CZK. Monthly tax discount on child is then 1,117 CZK. With social and health insurance paid by employee (2,913 CZK) and the same paid by employer (8,999 CZK) we get a final tax payment of 14,050 CZK. Mr. Novak’s net income therefore is 21,416 CZK.

Now we need to calculate **B** (base for instalment) using aforementioned formula.

Total debt	1 000 000 CZK
Amount which can not be forfeited	12 357 CZK
Monthly forfeited by insolvency trustee	9 059 CZK
Monthly insolvency trustee's commission	900 CZK
Monthly instalment for debt relief	8 159 CZK
Amount possible to be paid in 5 years	478 200 CZK
Part of debts possible to be paid in 5 years	49%

Figure 6 Debt relief calculation, own work

As it is obvious from the figure above, Mr. Novak is in current situation able to pay 49% of his debts. It means he may apply for debt relief and his application may be approved, while he is able to pay more than 30% of his obligations.

6.2.1.1. Economical impact on debtor

In case of accepting his application and approving debt relief by insolvency court, he will have to pay only 478,000 CZK of his original debt of 1,000,000 CZK. This court decision makes his five creditors register a loss (proportionally divided) of 522,000 CZK they were suppose to get back from him. Mr. Novak, however, will have only 12,357 CZK to pay for his and his family's living needs in upcoming 5 years.

Important part is the impact which debt relief has on a debtor after finally repaying set part of debt. So is in case of Mr. Novak, while he as a debtor is for next 5 years still kept in the database of the Central Register of Debtors in the Czech Republic. During this period he might experience loan rejection as well as rejection in case of buying goods on instalments. It is also possible that his loan application will be accepted, however his interest will be much higher. This and other problems at any other kinds of activity within the credit system are a result of irresponsible debts incurring.

Since repayment schedule was chosen as a method for Mr. Novak's debt relief case, he did not face the problem of selling his property and therefore for instance losing his house or flat which was used as a security deposit for his debts. This way Mr. Novak does not need to deal with the situation with becoming "homeless" due to involuntary selling of his property.

6.2.1.2. Socio-psychological impact on debtor

The problem of being indebted so much that an individual is not able to repay their obligations is frustrating itself. Another socio-psychological factors came in effect due to this situation.

Each employer is informed by an insolvency trustee about his employee's situation. During the period of debt relief, employer must divide his employee's (in our case Mr. Novak) income in two parts. First part consists of the minimum amount that can not be forfeited, the second is sent to a trustee who then organizes fulfilling the repayment schedule. The author of this thesis decided to note this aspect of debt relief under socio-psychological impact since it may strongly influence their employer's opinion and perception of debtor.

Since the Central Register of Debtors in the Czech Republic is a public register, anyone may find out about debtor's situation. This may cause strong reactions of society therefore affecting debtor's position in society.

6.2.1.3. Economical impact on creditors

No matter which form of insolvency, it is always a bad news for a creditor. As stated before, creditors lose a significant part of their claims. In Mr. Novak's case, we are talking about an amount of 521,800 CZK. If talking about finances of medium to large creditors, this result does not necessarily need to be very significant for them to apply special rules of protection against these situations in the future². On the other hand, for small creditors, this amount may be crucial for their financial situation and for their future decision making.

Before even starting a debt relief process of debtor using repayment schedule itself, each creditor must claim for their obligations within the period of 30 days since the resolution about accepted debt relief. This might have a crucial impact mostly on small creditors. The reason is that debtor is not obliged to inform them about their situation so it is easily possible for creditors to miss out on the period and instead of getting back at least a part of their claims, they lose the full amount. Large credit companies usually use software to control current situation at the Central Register of Debtors so the probability to miss out on this due date is almost equal to zero.

² This statement will later be discussed in an interview with ing. Jiří Popolanský of HomeCredit a.s.

6.3. Debt relief from a creditor's point of view

As stated in the previous part, insolvency of a debtor is always a negative point for creditor. It is no different if we talk about small, medium or large creditors or credit companies. However, their perception of this legally-economical institute might also be positive from some point of view. This way they might get at least part of their claims back.

To prevent this unwanted situation, every creditor uses their own methods. These may differ among all of them but in critical points those are no different. It is important to note though, that no relevant creditor such as large credit companies as Home Credit or any bank will ever provide complete conditions of their internal processes. However, few relevant information obtained will be used for the purpose of this thesis.

6.3.1. Evaluating and minimizing the credit risk

As it is written in the final document of “Principles for the Management of Credit Risk” by Basel Committee on Banking Supervision, the credit risk is to be understood as “the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms”. When taking this definition in consideration, creditors then usually behave as regular entrepreneurs. The reason they provide financial loans is therefore same as a goal of any other entrepreneur: to retain profit with a minimal risk. It means that in any business, evaluating the risk is one of the crucial parts of being successful. And so it is with creditors, no matter whether we talk about small local creditors, medium national or large supranational credit companies. The process of evaluating the risk is therefore one of the most important parts of their activities to limit the risk of losing significant amounts of money. To highlight its importance it is good to know, that underestimating the evaluation of risk was even one of the main reasons for the infamous Great Recession, a result of the US Subprime mortgage crisis of 2007.

6.3.1.1. Credit risk

If choosing banks as a model creditors for use in this thesis, following points are the most important for minimizing the credit risk:

- precise credit analysis of client

- sophisticated rules of providing and drawing credit
- precisely prepared loan agreements and terms and conditions
- rules of creating reserves and taking problematic debtors into consideration

As Babouček stated, there are two forms of credit risk, which are principal for analysis of risk. First is on debtor's side, where a creditor risks that debtor will not fulfill their obligations. The second part is so-called bound risk of a product, which is connected directly with a product itself as it is obvious from its name.

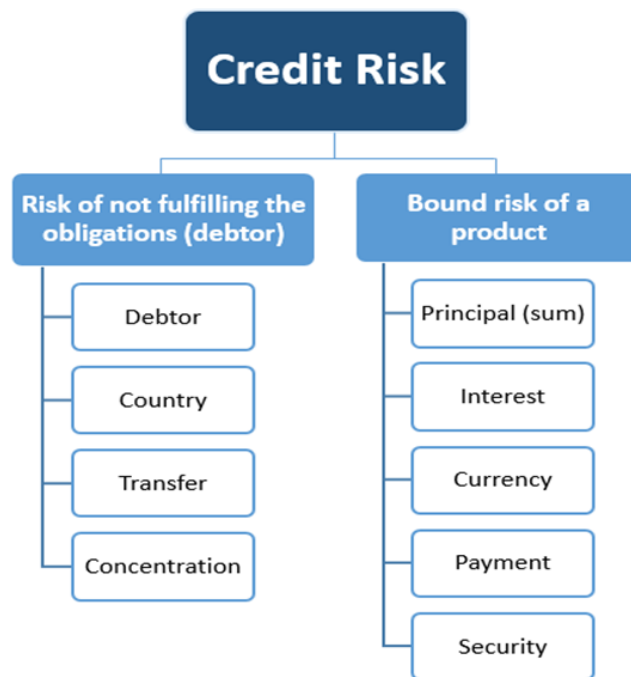


Figure 7 Types of credit risk according to Babouček (2005)

Figure above is a general diversification of credit risk. Since the topic of this thesis is debt relief of an individual, only debtor and concentration part of Risk of not fulfilling the obligations (debtor) are important for us. When talking about Bound risk of a product, all points shall be included.

Risk of not fulfilling the obligation on a debtor's side

Risk of debtor is simply a risk of debtor not being able to pay their debts to creditor. This may cause direct loss for a creditor.

Risk of concentration is to be understood as a consequence of small diversification of a creditors' loans and debtors portfolio. For the case of this thesis, it is quite limited risk, since a variety of products and clients is limited to consumer loans, mortgages and similar, as well as just to individuals (or entrepreneurs in certain cases). In general though, it means that if a credit company does not offer wide range of products to different types of clients, it risks great losses. (Colquitt, 2007, p.11)

Bound risk of a product

Principal risk is the risk of loss of amount which has yet not been repaid.

Interest risk could be described as a risk of negative impact of changes of interest, both active and passive, on a creditor's net income.

Currency risk is to be taken in consideration for cases when providing loans in different currencies. The risk resulting from this system is a loss as a consequence of deviations of current exchange rates.

Payment risk occurs when a debtor does not process their payments or processes them after a due date.

Security risk is a risk connected with a secured loans. It means that creditor may suffer a loss in case of a decrease in value of a subject of security. (Babouček, 2005)

6.3.1.2. Credit risk management

Correct credit risk management is a crucial point in minimizing the risk. The field of crediting is very risky in nature which puts an enormous importance on this field. Taking a risk of borrowing money to someone is though compensated in a form of solid earnings in sense of interest. The important point therefore is the correlation between taken risk and earnings. Higher the risk, higher the earnings. On this basis, banks try to take the highest risk acceptable to retain the highest possible profit. For this process, they use educated credit risk managers, who accompanied by sophisticated system, evaluate the risk in particular cases.

Process of credit risk management is usually divided in **5 phases**:

1. Identifying the risk

In this phase, the risk management of a credit company usually looks for any possible risk that could occur. It means precisely defining the risk before its possible appearance. Precise recognition of both internal and external sources of risk is a critical point as well. Risk capacity as a measure of how much risk a company is able to take (thelawdictionary.com, online) is a part of this phase.

2. Risk rating

Is a process, where the risk management calculates a possible loss of a provided loan. Based on this rating and a quantification of a possible risk, creditors make a decision on whether to grant a loan, what will the interest rate be, how will the loan be secured, creating reserves and how to monitor that.

There are **two methods of credit risk evaluation** according to Smejkal and Rais (2010):

Based on absolute position of credit risk, where risk is to be represented by a total value of a loan, all instalments with interests and administrative fees included. Final value might be reduced (in favor of a debtor) by securing a loan with fine security. In this case, credit companies do not create reserves unless loan conditions are broken by a debtor.

Based on expected rate of not repaying the debt, which estimate not only a total amount of an expected loss but a probability of this loss as well. Total predicted amount of the loss is then calculated as a product of probability and amount of loss. The risk management section then categorizes this particular loan and assigns it a risk rate. Risk category then influences creditor's decision on an amount of provided loan, interest rate, method of monitoring this loan and its repayment, amount of reserves and what kind of security must be put into question.

3. Securing the risk

Importance of this part is not lower than of two previous. In fact, it significantly decreases the risk of providing a loan, while during this process creditor uses assets of a potential client or a third person to cover for their loan. This means that in extreme case of not fulfilling the loan conditions, creditor is authorized to use revenue of selling secured asset in question to satisfy his claim. However, for its susceptibility to be abused, this institute of securities is regulated in Czech legal system.

4. Application of internal systems of risk management

Each creditor is allowed to use their own internal system of credit risk assessment. For instance banks are allowed to use these internal systems according to Basel II, one of recommendations and regulations on banking loans issued by the Basel Committee on Banking Supervision (informal advisory authority) . Most of them are quite complicated but again, they work on similar principles.

Basically each of these systems uses basic solvency evaluation of a client – client’s rating. It is a process by which a creditor rates a possibility of a loan to be non performing (Non Performing Loans will be discussed later). As a practical example we may use types of ratings published by Ceska Sporitelna a.s. (2010):

Internal rating		External rating	
Investment grade	1	Extremely strong	AAA
	2	Very strong	AA
	3	Strong	A
	4a	Good	BBB+
	4b	Highly satisfying	BBB
Speculative grade	4c	Satisfying	BBB.
	5a	Medium-low risk	BB+
	5b	Medium risk	BB
	5c	Medium-high risk	BB-
	6a	Vulnerable	B+
	6b	Highly vulnerable	B
	7	Weak	B-
8	Risk of loss	CCC, CC	
Default	R	Non performing loan	D

Figure 8 Rating types according to Česká Spořitelna a.s.

As it is obvious from a table above, Česká Spořitelna made a division of client’s based both on internal and external rating systems. The division consists of two grades where all ratings in investment part are not risky for the company. On the other hand all client’s applying for a loan from the second-speculative-part of rating are risky and therefore the loan premium resulting from providing a loan must be higher-creditor applies higher interest rate.

Another type of client's rating was published in the same publication using a rating types of Czech National Bank (CNB) in 2014:

	Moody's	Standard and Poor's	Fitch		Moody's	Standard and Poor's	Fitch
1992	Ba1	-	-	2003	A1	A-	A-
1993	Baa3	BBB	-	2004	A1	A-	A-
1994	Baa2	BBB+	-	2005	A1	A-	A
1995	Baa1	A	A-	2006	A1	A-	A
1996	Baa1	A	A-	2007	A1	A	A
1997	Baa1	A	BBB+	2008	A1	A	A+
1998	Baa1	A-	BBB+	2009	A1	A	A+
1999	Baa1	A-	BBB+	2010	A1	A	A+
2000	Baa1	A-	BBB+	2011	A1	AA-	A+
2001	Baa1	A-	BBB+	2012	A1	AA-	A+
2002	A1	A-	BBB+	2013	A1	AA-	A+

Figure 9 Rating types according to CNB, source:

A system of **scoring** as a part of client's rating is a process using simplified rating of clients based on basic information without including more complex qualitative criteria. Banks and credit companies usually use age, income, education, type of employment contract, etc. to sieve the clients who go through the application process. Creditors use it to minimize possibility of providing a loan to a client who is possible to become insolvent and potentially applying for debt relief and cause them a financial loss. (Fight, 2004, p.42)

From own experience of an author as a former employee of a large Czech commercial bank, the scoring process is really strict. It is applied to every client without any exceptions. As it has already been mentioned, specific information can not be published without agreement of a bank or any other credit company, but in general, the whole initial process is quite simple using basing algorithm with few variables mentioned above (age, income, employment contract type, education, etc.). This particular bank used simple scoring program to initially accept or reject the loan application. Afterwards, an individual approach to each client comes in question and in this phase it differs creditor to creditor.

From a research done for this thesis how to protect against insolvent clients or clients vulnerable to be insolvent, it was found out that credit companies like Home Credit in this particular case use

a very similar system of evaluation. This system then differs on a branch of crediting, which means what types of loans are to be provided.³

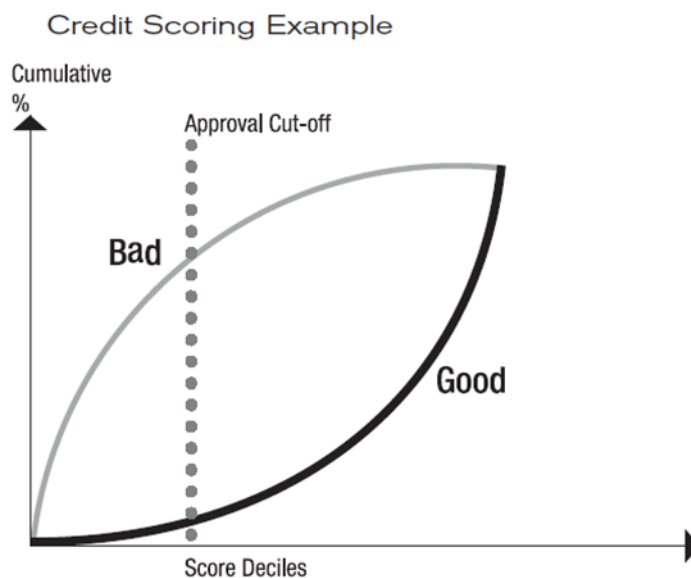


Figure 10 Credit scoring example, used from Colquitt

In a figure above a typical example of a credit scoring graph is shown, according to Ernst&Young (2005). This model is used by a creditor to distribute an interest rate corresponding to a rating score of an applicant. Higher the score, lower the risk for a creditor and lower interest rate as a result for a client. The reason is a risk probability increases with lower score and so the creditor must get higher reward in terms of higher interest for undergoing higher risk.

If the applicant gets through all of these phases and creditor provides them a loan, the whole process of prevention does not come to an end. It must continue with:

5. Risk monitoring

Noticing a potentially insolvent debtor is important part of credit risk management in practice. Once creditor borrows money to a client, they should still monitor their claim. Creditor usually monitors:

³ According to ing.Jiří Popolanský who was interviewed for the practical part of the thesis

a) if a repayment schedule is being fulfilled, financial statements of a client, securities value in comparison to a value of a claim in question, debt register records, etc.

b) development in macroeconomics and sector indicators which could have an impact on particular case.

In our case of individual's loans however, the importance of this part decreases, since it is oriented towards higher loans for companies and entrepreneurs.

The risk management must always monitor evolution of risk profile in comparison to what is expected to prevent potential losses, according to Van Gestel (2009).

6.3.1.3. Results of using credit risk management strategies

As mentioned before, no relevant institution will provide specific information in real numbers. However, based on research and cooperation with ing. Jiří Popolanský, following table was completed to give an insight on a scoring in practice applied on car loan applications:

Reasons for rejecting applications	%
High involvement in credit system	0,54%
Blacklists	0,29%
Solvency of a client	3,28%
Central register of executions	2,79%
Negative link to a certain subject	0,64%
Debtor	2,30%
Excessive value of a subject of loan	3,38%
False documentation (ID, etc.)	0,30%
Negative credit history in NRKI	9,84%
General terms and conditions	11,38%
Correction of details from client's side	1,08%
RISK	0,17%
SCORE	1,85%
Negative Credit history in Solus	3,53%
Verification of client problems	8,39%
Subject ineligible to be financed	0,13%
Denial on a complaint from object's provider	3,22%
Rejected applications	53,11%
Approved applications	46,89%

Figure 11 Reasons for rejecting applications, own work, source of data is Home Credit a.s.

Based on the statistics gained from a research, it is obvious that more than 53% of applications on car loans are rejected from various reasons. For our case of possible debt relief few of these are important. High involvement in credit system, client's solvency, fact the client is a debtor, negative credit history in NRKI, RISK in sense that risk management employees reject the application based on internal regulations, SCORE in sense that client went through scoring system with score so low they can not provide a loan to them, and a negative credit history in Solus (credit register widely used by any company providing any kind of credit trade).

As a result of these credit risk management phases and methods, very small number of potentially bankrupt clients are provided with loans. According to risk management office of Home Credit, during the lifecycle of a loan agreement, there is just about 0.3% of clients who are approved with debt relief which means company's loss. That is quite insignificant number in comparison to their net profit on each product they sell. These information are however prohibited.

6.4. Perception of debt relief by Home Credit a.s.

To point out practical impact of debt relief on real company and their management, I decided to do a short interview with a credit risk specialist in transnational credit company Home Credit a.s. The goal was to find out and generalize, how does a prevention process work, what kind of a threat does debt relief represent, and whether would the company made any significant steps in reaction to a possible cancellation of a limit of minimal 30% of fulfilling discussed in relation to the topic of this thesis.

How does a credit company measure solvency and creditworthiness of a client applying for a loan?

It is important to note that any credit risk specialist authorized to measure solvency of a client uses a NRKI⁴, a register under a CRIF⁵, as a starting point for the whole process. In the NRKI all important information for credit system are included. If a specialist inserts client's name in NRKI's search engine, they get a complete information on client's current debts, if instalments on debts

⁴ Non-banking register of clients' information

⁵ Czech Credit Bureau - A founder of the banking and non-banking Credit Registers in the Czech Republic. A reputable company delivering solutions for credit risk management, operating tools for rating / scoring evaluations of various subjects and providing information on business subjects. Source: www.crif.cz.

already that have already been repaid in time⁶. Then the specialist proceeds to next part which is inserting all relevant data into internal credit risk measurement system. This system has its own algorithm to control every information it receives and as a result it gives a resolution whether to accept or reject the loan application. As a supporting part of a computer driven process, a human factor engagement in form of controlling income statements of each client is implemented.

Is a growing number of debt relief cases and debt relief itself a real threat in sense of significantly changing loan conditions and other management steps from company's point of view?

Obviously, as any other company providing any kind of loans we noticed a growing number of debt relief cases in last years. However, this phenomenon is still not significant enough for us to be influencing heavily our loan conditions like rapidly growing interest rates, applying restrictive rules of loaning, etc. The interest rate is definitely influenced, but only in a matter of hundredths of percent. No significant changes in risk management processes are considered in relation to this concept at the moment.

When mentioning loan conditions and credit risk management process, how is the debt relief represented in these? Would a possible change in a limit of minimal 30% repayment influence product prices and interest rates?

Anytime a company providing loans sets up a new product, it is up to risk management section of the company to take every possible risk in consideration. As a output of this process, they set up so called netto and brutto LOSS. It is a form of financial analysis risk managers use to measure how much of provided financial assets is acceptable to be lost so the product as a whole is still profitable⁷. This particular part, expressed in percentage, is then perceived as a risk capital, which is covered by interests retained from other contracts connected with the product in question. If there appears a loan which is being collected for more than 360 days, it is subtracted and not included in brutto LOSS anymore.

Debt relief is then included in netto LOSS. If a client becomes insolvent and the whole process of debt relief in form of repayment schedule starts, we expect to retain only a small part of our claim.

⁶ For this case a term "payment morale" may be used

⁷ This measurement uses percentage as a measure system.

Netto LOSS is then one of the indicators, which moves interest rate up and down the scale. It means that in case of extreme growth of debt relief cases, the interest rates of new coming or actualized products might be impacted. The same may be applied for a change in a 30% limit as a minimum repayment. It would definitely influence the interest rate but not in any enormous extent.

6.4.1. Interview conclusion

As it was found out in the interview above, debt relief is definitely noticed by risk management specialists as a phenomenon that must be taken in consideration when creating loan conditions. However, thanks to their credit risk management processes, its actual impact on their decision making is not very strong. In practice, the impact of debt relief could be simplified as a very slight growth in annual interest rates and no radical changes in credit risk management processes.

7 DISCUSSION

The main goals of this thesis were to analyze the concept of debt relief as an economically-legal procedure, which helps debtors restart their lives as well as making creditors lose significant amounts on the other side. At first, the goal was to point out its impact on credit companies within the Czech Republic. Practical examples, research and consultations were supposed to be the tools to show how debt relief works, and what impact does it have.

As I found out throughout writing this thesis, debt relief has its roots way back in history. However, the form it is applied in today is different, strictly defined and regulated by particular sources of law. It is a concept which is thoroughly thought-out with giving debtors a possibility of “having a fresh start” in terms of their financial condition. As I found out during literature research, there are two ways of debt relief, selling debtors property and repayment schedule. I decided to take repayment schedule as a relevant form for larger part of this thesis, while it is applied in more than 96% of cases.

What was surprising was the fact it is discussed that a limit of repaying minimum of 30 % of debts using repayment schedule method could be removed. According to the assumption made before, this could have quite a big impact on field of crediting. In my opinion, it would be another significant step to prefer debtors' interests to creditors'. It is obvious that sometimes debtors come into the situation of having unpayable debts just because of set of coincidences and can not really do anything to prevent these situations. However, I believe everyone should use strict personal financial management rules to at least minimize the possibility of having to apply for debt relief. There are all kind of forms of financial advisory, more or less efficient and sophisticated. And in todays world of the internet, anyone in our region have a possibility to find information about how to manage their financial situation.

As it was already mentioned, the expected impact of debt relief on credit companies to be quite significant. However, throughout working on this thesis and working on a practical part, it has been showed that debt relief is not such a threat I expected it to be. The reason is that credit companies (including aforementioned Home Credit) use so-called credit risk management to prevent these situations and minimize the risk of their occurrence. Specific processes like internal scoring as an evaluation of a client and whether to provide him a loan or not are included, and are the front line

defense against providing troubling loans. As a very beneficial for this thesis, I consider consultations and the interview with credit risk specialist Ing. Jiří Popolanský who works for Home Credit. Information he provided were very useful to create an image on how debt relief and its prevention in form of credit risk management works in reality. On the other hand, it disproved my assumptions stated in the introduction. Debt relief according to him has a minimal impact on their decisions, since there is just about 0.3% of clients with this case of insolvency. And even though they lose some money due to this concept, they compensate it when creating new products. During this process, they evaluate its expected profitability and includes debt relief as a part of their calculations. However, it still has just a very small impact on product's final price.

8 CONCLUSION

As the main goal of this thesis it was set to research processes of debt relief and evaluate its impact on credit companies. Throughout working on this thesis, importance of its actual impact even on debtor came in question and therefore was presented.

To fulfill these goals, all methods presented in the methodology part were used. Descriptive method with a use of scientific literature and other sources was used especially to define what debt relief is. The same method was also used to describe its development in form of short historical excursion, and then to research how the whole process works. For theoretical part, case studies were the main tool to give an insight on the process of debt relief in practice with impact it actually has. A research and consultations with specialists from practice then were a method to obtain information as relevant and useful for this thesis as possible. As a result it produced various interesting numbers in tables such as with reasons for rejection, as well as an advice on what kinds of protection credit companies use to prevent providing troubling loans. These methods were then described with a use of reference books and later discussed in the interview with a credit risk management specialist. Answers on questions in this interview then finally completed a complete picture on what debt relief really means to credit companies, what impact it has and whether they see it as a real threat.

The main goal of the thesis therefore was met, since the actual impact of debt relief on credit companies was described and discussed. However, throughout working on this thesis, aforementioned assumptions that debt relief significantly influences credit companies were partially disproved. As it was stated, reason is that these companies use a sophisticated system of credit risk management to minimize possibility of providing loan to a potentially insolvent client. And while the importance of debt relief to credit companies is not really big, it might be perceived as the only way out of critical economical situation for individuals from another point of view.

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