

Research on the "Honest but Unfortunate" Debtor Identification Criteria in the Construction of the Personal Bankruptcy System

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Abstract

Since the implementation of the "Personal Bankruptcy Regulations of Shenzhen Special Economic Zone" in 2021, the construction of the personal bankruptcy system in China has gradually entered the stage of practical exploration. How to accurately identify "those who are honest but unfortunate" determines whether the bankruptcy relief can play its due role. This article compares the integrity review systems of personal bankruptcy systems in foreign countries, based on case analysis of the practical difficulties in the determination standards in the pilot practice of China, and attempts to provide a standard system for the following judicial trials and system improvement.

Keywords

Personal Bankruptcy; Honesty But Misfortune; Creditworthiness Review; Loss of Authority and Restoration of Authority.

1. Introduction

1.1. Background and Significance of the Topic Selection

In recent years, the domestic market environment has changed rapidly, and consumer credit has become almost ubiquitous in people's daily lives. Along with this trend, the risk of accumulated personal debt has gradually emerged. The "Personal Bankruptcy Regulations" introduced in 2021 provide a new way for personal debt restructuring, aiming to offer an additional option for some debtors who truly need help. However, the issue of who qualifies as "honest but unfortunate" varies depending on different cases, and if this cannot be clearly defined, such a system lacks fairness and stability, making it difficult to be stable. Therefore, we need to re-understand this concept from aspects such as practical cases, legislative purposes, and social expectations, and then gradually construct specific and feasible criteria for its determination. [1]

1.2. Literature Review

1.2.1. Domestic Research Status

During the process of collecting relevant materials, the author conducted a comprehensive search through various channels such as online databases, various public account articles, books, and interviews. Regarding how to understand and grasp the criteria for determination, different scholars have different classification methods. Taking Hu Shouxin's viewpoint as an example, he believes that "debtors who are honest but unfortunate" should simultaneously undertake and abide by several obligations closely related to integrity. These requirements ultimately point to a fundamental principle of the bankruptcy procedure - the principle of good faith. Li Yongjun and Guo Yongchao believe that "incurring debt due to legitimate reasons" is the primary condition for determining that a bankruptcy applicant is "honest but unfortunate".

1.2.2. Current Research Status Abroad

Articles such as those published in the "American Journal of Bankruptcy Law" tend to focus on the identification of "abuse of procedures" and develop reliable methods such as "economic condition investigation". In Germany, the academic community's discussion on the "creditor's good faith" requirement and the "good conduct period" in the "Consumer Bankruptcy Law" mainly focuses on the examination of the debtor's behavior throughout the bankruptcy process. In Japan, the academic community has conducted in-depth discussions on the applicable conditions for small-scale individual rehabilitation procedures based on the "Civil Rehabilitation Law". These studies provide comparative law materials, which need to be adapted in light of China's own national conditions[2].

1.3. Main Research Methods

During the research process, by reviewing the legislative texts, academic articles, judicial interpretations, and related comments on the personal bankruptcy system from both domestic and international sources, we were able to sort out the understanding frameworks of "honest but unfortunate" debtors in various countries. The bankruptcy systems of countries like the United States and Germany are already quite mature, and the underlying concepts behind their systems, especially the balance between debtor's honesty and relief, are of significant reference value for our country. At the same time, the "Shenzhen Special Economic Zone Personal Bankruptcy Regulations" as the most representative local law in China also provides many institutional details for observation. These materials collectively form the basic reference for establishing the identification criteria in this research. The analysis of specific cases is also very important. By comparing those who become indebted due to external reasons such as poor management or illness with those who incur debts due to subjective faults such as gambling or excessive consumption, it is possible to more clearly delineate the boundaries between these two types of situations.

2. Comparison of the Credit Review System in Foreign Personal Bankruptcy Laws

The principle of "honest but unfortunate" originated from the 1934 US Supreme Court ruling in the case of *Local Loan Company v. Hunt*, and subsequently, various countries with a legal system around the world have followed this principle to develop their own systems for evaluating honesty [3].

2.1. United States

Two representative systems in the personal bankruptcy system of the United States are the Chapter 7 and Chapter 13 systems. These two systems establish a complete and strict screening procedure to determine whether to test the debtor's integrity. The first step involves a comprehensive property declaration process. After the debtor submits a bankruptcy application to the court, they must fill out official forms that are several pages long, providing information on all their properties, income, debts, and recent financial transactions across the world. Any act of false statement, concealment, or omission will likely result in the case being directly rejected or the debtor facing the possibility of federal criminal charges for "bankruptcy fraud" and related criminal liability. Therefore, the strict obligation to disclose facts is the prerequisite for subsequent related reviews. The core technical tool is the "means test", which determines whether the debtor has the ability to repay part of the debt according to the Chapter 13 procedure within the next three to five years. If the debtor's income is much higher than the median and they still insist on applying for Chapter 7 to obtain debt relief, the court may consider this as a "substantial abuse" and reject their application or force a conversion to the Chapter 13 procedure. Through this economic test, it

effectively avoids dishonest behaviors such as those who intend to abuse the bankruptcy process to evade the repayment of debts.

2.2. Britain

Before the declaration of bankruptcy, a comprehensive review of the company's transactions must be conducted within a certain period of time. Such reviews should cover illegal gambling debts, huge debts incurred due to gambling or other non-essential activities, and the fact that despite knowing the inability to repay, large amounts of debt were still taken on. In such cases, the official receiver can apply to the court to issue a "bankruptcy restriction order" to the debtor. The duration of the writ can be freely adjusted within a range of 2 to 15 years. The specific restrictions include: without the court's permission, one cannot serve as a director of the company; one cannot participate in the establishment and operation of the company; one cannot use certain names for commercial activities, etc. This has a good governance effect.

3. Realistic Predicament

By analyzing typical cases in places like Shenzhen, the main practical problems can be summarized as the ambiguity of standards. In the case of the pilot areas, the phrase "honest but unfortunate" has been frequently mentioned, but currently there is a lack of relevant legal provisions. Based on cases such as Huo's case and other published cases, when applying this concept in courts, various factors such as "behavioral performance", "subjective motivation", and "causes of debt formation" are taken into consideration [4]. Although this comprehensive judgment provides courts with a certain degree of discretion, it also contains too much subjectivity and uncertainty, which can lead to inconsistent and unstable judicial determinations.

Take the case of Huo as an example. In this case, the debtor Huo invested and operated Shenzhen Huoyan Culture Development Co., Ltd. from 2014 to 2016. The company's business location was located in the Jingji Dongfanghuadu Building in Luohu District, Shenzhen, along with the New Yijia Supermarket. Due to the bankruptcy of New Yijia Supermarket Co., Ltd., Huoyan Culture Company had to close down, resulting in Huo incurring debts of over 4.8 million yuan [5]. In 2018, Huo sold his only residence and used the proceeds of 2.6 million yuan to fully repay his debts. However, there were still over 1.06 million yuan remaining that could not be settled. On June 9, 2021, Huo filed for personal bankruptcy. On September 2, the Shenzhen Intermediate People's Court ruled to accept his bankruptcy liquidation application and appointed a bankruptcy administrator. The court identified the reasons for Huo's "honest but unfortunate" situation as follows: the debts mainly stemmed from business failure; the debtor had sold his property to repay the debts; no evidence of concealing assets or other dishonest behaviors was found [6]. Although these reasons have their rationality, if they are adopted as a universal standard, it is likely to lead to "case-specific justice". Through empirical research, it can be seen that currently, the definitions of "unethical behavior" vary from place to place. In some areas, almost all violations of civil and commercial obligations are regarded as unethical, even including administrative violations unrelated to bankruptcy, resulting in the "honesty" standard being too broad in practice. If the review is too strict, the debtors who should be protected will be unable to enter the bankruptcy process, while if the review is too lenient, it may affect the credibility of the system.

Due to the lack of unified quantitative standards and structured review mechanisms, the determination of "honest but unfortunate" often relies on the experience of managers, judicial discretion, and the opinions of creditors, making it difficult to ensure consistent handling of similar cases and resulting in uncertainty in the implementation of the system. This uncertainty is at the core of the current predicament.

4. Establish a Multi-level Identification Standard System

To avoid subjective arbitrariness in the identification process and to enhance the operability and predictability of the standards, efforts must be made to decompose the core elements of "honesty" and "unfortunate" into a series of observable, verifiable, and quantifiable specific indicators. In the objectiveization of the "honesty" standard, negative behavior lists and integrity scoring mechanisms can be considered. The negative behavior list should clearly list typical behaviors that constitute "dishonesty", such as providing false or incomplete property and debt information, with an error rate exceeding a certain proportion; during the specific period before bankruptcy application, there are reversible behaviors such as abnormal price property transfers, preferential repayment to individual creditors, gratuitous transfer of property, etc.; deliberately destroying, hiding or refusing to provide important documents such as account books and vouchers related to the property status; making false oaths or statements regarding important matters in the bankruptcy procedure; refusing to comply with the legal instructions of the court or the administrator without justifiable reasons. If any of the behaviors listed in the list exist, it should be directly presumed that the debtor does not possess the "honest" quality [7]. At the same time, an integrity scoring model can be attempted to be established to quantitatively score the debtor's behaviors in property declaration, procedural cooperation, and historical repayment performance, as an auxiliary tool for comprehensive judgment. It is necessary to master the "unfortunate list" for determining "unfortunate" and excluding "unfortunate", as well as the corresponding proof standards. The "unfortunate" list refers to sorting out and clarifying some common "unfortunate" situations and making specific provisions in relevant norms. The proof standard for "unfortunate" is generally how to provide evidence for different types of "unfortunate" situations. For example, for the "unfortunate" situation of sudden major illness, a diagnosis certificate and medical expense invoice issued by a tertiary general hospital need to be provided to the court; for the "unfortunate" situation of involuntary unemployment, the creditor should submit the corresponding unit's termination of labor contract certificate or unit attendance certificate, overtime certificate, termination or cancellation of labor (employment) contract certificate, etc. On this basis, there should also be a clear judgment principle, that is, whether it is a "direct causal relationship" and whether it is the main reason for the debtor's insolvency and inability to repay. If the main liability of the debtor is caused by their own fault, then such "unfortunate" cannot be recognized as "honest and unfortunate" [8]. Furthermore, there should be a list to clarify the behaviors that, by definition, cannot be classified as "unfortunate". Such behaviors include debts resulting from illegal activities such as gambling and drug use, debts incurred due to purchasing expensive luxury items or engaging in extremely risky speculative activities, and loans obtained through fraudulent means despite knowing that they cannot be repaid. On the basis of clearly delineating the "two-sided" boundaries, the criteria for determining "unfortunate" situations should be specified.

5. Conclusion

Establishing the "honest but unfortunate" debtor identification criteria is the foundation for the establishment and growth of the personal bankruptcy system. Through research, this article discovers that this standard requires a shift from moral value judgment to technical rule design. However, relying solely on judicial discretion is difficult to create a stable expectation. Therefore, China should, based on respecting its own national conditions, draw on foreign experience, strengthen property declaration review, debt cause analysis, and debtor behavior supervision, and construct a comprehensive governance mechanism covering pre-event warning, in-event review, and post-event supervision. Personal bankruptcy

involves multiple fields such as finance, taxation, and social security. It is necessary to further break down information barriers and build a unified integrity information platform to achieve a sustainable balance between protecting the rights and interests of creditors, maintaining financial order, and assisting honest debtors. This will lay a solid foundation for the healthy development of China's personal bankruptcy system.

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