

# Executive summary

## Introduction

The aim of this research is to gain a better insight into the nature and size of the group of habitual offenders in bankruptcy fraud and their modus operandi. This study also attempts to provide insight into how habitual offenders of bankruptcy fraud are handled by the various actors and how this approach can be improved. Particular attention is paid to the possibilities and impossibilities of proactively identifying and following individual habitual offenders within the framework of the rule of law. To this end, the following two main questions are central: (i) **to what extent are there possibilities to detect professional fraudsters or habitual offenders in bankruptcy fraud and to identify the risk of recidivism at an early stage?**, and (ii) **how can the current approach to habitual offenders of bankruptcy fraud be improved in terms of detection, intervention, cooperation, information exchange and legislation?**

In addition, this research answers the following sub-questions:

1. Is there a shared definition of bankruptcy fraud and a profile of professional fraudsters or habitual offenders in bankruptcy fraud?
2. What does the group of professional fraudsters or habitual offenders of bankruptcy fraud look like and is it possible to estimate the number of professional fraudsters?
3. In the case of bankruptcy fraud, do habitual offenders work alone or more often in a network of bankruptcy fraudsters?
4. What is the policy theory behind handling habitual offenders of bankruptcy fraud?
5. What are the (effective) mechanisms in practice behind this approach to bankruptcy fraud?
6. Which parties are involved in addressing bankruptcy fraud, what are the tasks of the individual parties and how do these parties work together and inform each other?<sup>1</sup>
7. Which identification and/or intervention options are currently available in a preventive and repressive sense and what is known about their effectiveness?
8. How often is suspected bankruptcy fraud reported by a bankruptcy liquidator, what is the number of cases that have been investigated and how often are legal proceedings instigated?
9. What does the criminal law approach of these habitual offenders and their networks look like in practice?
10. What improvements are possible in handling habitual offenders of bankruptcy fraud and/or their network?
11. What conclusions can be drawn on the basis of this research with regard to good practices and bottlenecks in handling habitual offenders in bankruptcy fraud?

In answering these main and sub-questions, a combination of research methods was used: literature research, discussions with actors involved in handling habitual offenders of bankruptcy fraud, a survey among bankruptcy liquidators, a round table discussion with the actors involved and a case study into two bankruptcy fraud cases illustrating the modus operandi of habitual offenders.

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<sup>1</sup> This also addresses the privacy aspects of being able to share information about habitual offenders other than for criminal investigations.

## Policy framework and legislation

There is no single definition of bankruptcy fraud that is used by all parties. The term 'bankruptcy fraud' is not defined in the Dutch Criminal Code. The components of bankruptcy fraud, such as the obligation to inform the bankruptcy liquidator<sup>2</sup> and the prejudice to creditors or beneficiaries (culpable or fraudulent bankruptcy),<sup>3</sup> do, however, appear in the Criminal Code. The literal meaning of the word 'bankbreuk' [bankruptcy] is in practice regarded as the old synonym for bankruptcy fraud. The lack of an unambiguous definition is not regarded as problematic by the actors involved in addressing bankruptcy fraud. Additionally, certain actors - especially investigative judges - do not use a definition for bankruptcy fraud or habitual offenders, but use a 'red flag' system whereby they rely on signals from risks of bankruptcy fraud.

The policy regarding the approach to bankruptcy fraud falls within the integrated approach to bankruptcy fraud initiated in 2011, drawn up by the Dutch Ministry of Security and Justice.<sup>4</sup> The approach is also part of the fraud pillar of the 2012 program to review bankruptcy legislation.<sup>5</sup> The policy is based on prevention and repression. The aim of this is to prevent bankruptcy fraud and also to limit the risk of recidivism. On the one hand, the actors involved try to prevent and make it more difficult to commit bankruptcy fraud by erecting barriers.<sup>6</sup> Examples of this are the gatekeeper function of civil-law notaries and the preventive effect of an imposed and/or irrevocable director disqualification. On the other hand, there is an extensive set of legal instruments to deal with the offender of bankruptcy fraud after the offence has been committed. This involves a combination of criminal proceedings, measures under civil law, and tax measures. Within criminal law, the criminal director disqualification and the deprivation of unlawfully obtained gains are the most relevant options for punishing bankruptcy fraud. Within civil law, this concerns the Paulian action; the action arising from a wrongful act, including the Peeters/Gatzen claim; directors' and officers' liability, and the director disqualification under civil law.

Although the legal instruments are considered sufficiently extensive by the actors involved in the approach to bankruptcy fraud and to habitual offenders, various challenges are experienced in their application. For example, with regard to the director disqualification under civil law, there are doubts about whether this measure is being imposed on the correct group. This director disqualification is mainly imposed on straw men, so that the actual offenders go free.

## Habitual offenders of bankruptcy fraud

It is difficult to create a profile of an habitual offender of bankruptcy fraud. Roughly speaking, it can be said that habitual offenders of bankruptcy fraud are usually men, older than thirty years. In terms of socio-economic background, there seems to be no clear common ground; from this it can be concluded that the group of habitual offenders of bankruptcy fraud is more diverse than the typical white-collar criminal.

Three roles can be distinguished within the group of habitual offenders of bankruptcy fraud. This concerns the fraudster, the straw man and the service provider. The archetypal offender of bankruptcy fraud cannot be captured in one profile. This group of fraudsters is divided into four typologies, namely the fraudster motivated by crises, the fraudster who takes an opportunity that comes his way, the opportunity seekers, and stereotype criminals. Habitual offenders of bankruptcy fraud are usually best categorised as opportunity seekers, a group that knowingly and willingly looks for opportunities to commit bankruptcy fraud. However, the types of bankruptcy fraudsters are not completely independent of each other; persons develop and move between the different types.

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<sup>2</sup> Section 194 Dutch Criminal Code

<sup>3</sup> Section 340-349 Dutch Criminal Code

<sup>4</sup> Parliamentary documents II, 2010/2011, 32715, 1

<sup>5</sup> Parliamentary documents II, 2012/2013, 29911, 74

<sup>6</sup> Amongst others the tax authorities, Justis, private parties and the notary's office

Actors involved in addressing bankruptcy fraud are most able to track straw men.<sup>7</sup> This group is roughly divided between helpful family members and vulnerable people who act out of emergency. Here too, there is overlap between the types of straw men. It is not always clear whether this group is aware of their role in a fraud scheme. The group of service providers consists of persons who support the offender of bankruptcy fraud. This group includes persons who knowingly contribute to committing fraud as well as persons who are unconsciously incompetent and unaware of their role in a fraud scheme. The fraudster, straw man and service provider should not be seen completely separately from each other. For example, straw men and service providers can also develop into fraudsters. There is also a certain degree of dependence and people can assume a different role per case.

The networks in which fraudsters, straw men and service providers operate are increasingly fluid in nature. Where networks previously consisted of a fixed group of people, this is now the case to a lesser extent. Straw men and service providers are sometimes engaged for certain activities and can be connected to multiple networks. Also, networks involved in bankruptcy fraud sometimes engage in more serious crime as well. The classic image of one fraudster working together with one straw man is less and less common.

This study identifies the four most common modus operandi used by habitual offenders of bankruptcy fraud. This concerns (1) deliberately attracting ailing companies, (2) setting up companies with the aim of fraud, (3) expedited liquidations and (4) avoiding fines or sanctions. In each of these methods, use is made to a greater or lesser extent of a number of core elements that habitual offenders of bankruptcy fraud seem to apply. These core elements include the use of straw men, the deployment of service providers, the use of a network, making (many) changes to legal entities, setting up companies in different districts and the unwillingness to share the administration when a bankruptcy is filed.

It is also striking that habitual offenders of bankruptcy fraud have a preference for certain sectors. These sectors are particularly vulnerable to bankruptcy fraud, because it is easy to set up a company in these sectors, it does not require a degree or certification and there is little or no material investment required to start a business. Vulnerable sectors include the healthcare sector, the temporary employment sector and cleaning companies. In the context of the pandemic, the hospitality industry is also considered vulnerable.

The damage caused by offenders of bankruptcy fraud is considerable. However, the group behind this fraud appears to be relatively small. It is unclear what share of the bankruptcy fraud is caused by habitual offenders. In theory, it is possible to estimate the number of habitual offenders of bankruptcy fraud. In practice, however, it is difficult to map out the size of the group of habitual offenders of bankruptcy fraud because of the 'dark figure problem' (not all bankruptcy fraud is identified) and incomplete data at various actors (including the Dutch Tax and Customs Administration and Fiscal Intelligence and Investigation Service). Also, there is very limited insight into the extent to which expedited liquidations are abused by habitual offenders, while it is suspected that this is a popular modus operandi. Finally, bankruptcy fraud is not registered as such by all actors involved in addressing bankruptcy fraud (the police, amongst others), which makes it difficult to clearly see the scope of the problem.

### **Actors and their role in the approach**

A large group of actors is involved in addressing bankruptcy fraud. A distinction can be made here between the different phases within the approach to bankruptcy fraud: identifying, reporting, detecting and prosecuting.

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<sup>7</sup> This includes mostly the police, FIOD, tax authorities, trustees and the examining magistrate

The largest group of actors plays a role in identifying bankruptcy fraud. They can identify signs of bankruptcy fraud, for example at the time of the registration of a company and during its business operations (including the notarial profession, the Dutch Chamber of Commerce (KVK), the Dutch Tax and Customs Administration, the Dutch Social Affairs and Employment Inspectorate (ISZW) and the Dutch Ministry of Justice Agency for Scrutiny, Integrity and Screening). When bankruptcy has been declared, investigative judges, bankruptcy liquidators, the Chamber of Commerce, the Fraud Helpdesk, the Employee Insurance Agency (UWV) and the Healthcare Fraud Information Exchange (IKZ) can subsequently play a role in recognising bankruptcy fraud. The Financial Supervision Office (BFT), the Financial Intelligence Unit (FIU) and private parties also play a role in this. However, it should be noted that it is difficult to detect signs of bankruptcy fraud early on, because fraud is often only noticed after it has been committed.

Subsequently, in reporting a suspicion of bankruptcy fraud, there is a role for, among others, the Tax and Customs Administration, bankruptcy liquidators, the IKZ, ISZW, the notarial profession, private parties, investigative judges and creditors. They can report their suspicions via the FIOD's Central Bankruptcy Fraud Reporting Centre (CMF). Depending on the complexity of the report, the CMF then forwards the report to the police or the FIOD, who then take on the investigation.

In 2019, a total of 52 bankruptcy fraud cases were investigated by the police. In 2020 there were 50.<sup>8</sup> In 2019 and 2020, FIOD handled 46 bankruptcy fraud cases annually.<sup>9</sup> Finally, the Dutch Public Prosecution Service can prosecute bankruptcy fraud cases. Bankruptcy liquidators can take civil action. Figures on successful criminal or civil proceedings are lacking, partly because of the incomplete registration of bankruptcy fraud cases in systems.

## Conclusions

In answering the two main questions, the following conclusions can be drawn.

There are various options for early detection of bankruptcy fraud offenders. However, it is difficult to assess the effectiveness of these measures. Because of the 'dark figure problem', there is no insight into the total extent of bankruptcy fraud, moreover, all actors only have insight into a limited part of the problem.<sup>10</sup> There is also no complete picture of the group of habitual offenders and the modus operandi they use, so that the possibilities for early identification remain limited. There is also little insight into the risk of recidivism by bankruptcy fraud offenders. As a result, it is unclear to what extent identification instruments are effective.

In addition, other challenges also play a role. Actors involved in addressing bankruptcy fraud and/or handling habitual offenders do not use an unambiguous definition of bankruptcy fraud.<sup>11</sup> Various actors - particularly investigative judges - work with a 'red flag' system instead of a definition, based on indications of the risks of bankruptcy fraud. However, such 'red flag' systems are used by actors within their own organisation and are usually not or only to a limited extent exchanged with other actors. As a result, the systems are not aligned and some actors are not aware of the 'red flags' used by other actors.<sup>12</sup>

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<sup>8</sup> Dutch Public Prosecution Service Fraud Monitor 2019 and 2020, expected. Information shared with researchers by Public Prosecuting Service.

<sup>9</sup> Dutch Public Prosecution Service Fraud Monitor 2019 and 2020, expected. Information shared with researchers by Public Prosecuting Service.

<sup>10</sup> This mostly includes the police, FIOD, tax authorities, ISZW, trustees and the investigative magistrate.

<sup>11</sup> Amongst others, the definitions used by the tax authorities, investigative magistrate and ISZW differ.

<sup>12</sup> Except for Regional Information and Expertise Centres

Also, actors involved in addressing bankruptcy fraud and/or handling habitual offenders can only share information with each other to a limited extent, partly because of privacy legislation. In addition, some parties lack important powers (such as the notarial profession to have insight into imposed director disqualification) or information can only be shared when fraud or possible fraud has already been committed. Information is sometimes only shared between districts to a limited extent. Moreover, habitual offenders take advantage of the weaknesses of the collaboration between the various parties.

There are also doubts among actors involved in addressing bankruptcy fraud and/or handling habitual offenders as to whether certain measures are being used correctly. Among these actors, for example, there is the idea that the civil-law director disqualification is mainly imposed on straw men, as a result of which the actual offenders go free.

A large group of actors (including the Tax and Customs Administration, BFT, bankruptcy liquidators, the Ministry of Justice Agency for Scrutiny, Integrity and Screening (TRACK), FIU, the Fraud Helpdesk, IKZ, ISZW, the Chamber of Commerce, the notarial profession, private parties, investigative judges, creditors and the UWV) can identify and report bankruptcy fraud. However, the number of actors that can play a role in the investigation (the FIOD, the Public Prosecution Service and the police) is much more limited. Moreover, identifying suspected bankruptcy fraud is not a priority for all actors. For part of the bankruptcy liquidators, reporting suspected bankruptcy fraud is a matter of secondary importance. As a result of past experience, the willingness of bankruptcy liquidators to report has also been affected and some of them feel that the chance that a report will be addressed is small.

Moreover, investigative services are faced with a lack of capacity and bankruptcy fraud is not always a priority. This means that fewer cases of bankruptcy fraud are addressed, which results in limited knowledge building in the field of bankruptcy fraud within the police organisation. When it is decided to do take up a bankruptcy fraud case, the investigative authorities and especially the police sometimes lack knowledge of financial investigations and experience in this area. Finally, the Public Prosecution Service also struggles with capacity problems, which means that bankruptcy fraud cases are sometimes concluded with a settlement.

In order to improve the current approach of habitual offenders of bankruptcy fraud, more efforts should therefore be made with regard to effective prevention. This can be done, among other things, by creating a better information base by conducting more and in-depth investigation into, for example, the suspected abuse of expedited liquidations. Additional research could also help to form a better picture of the risk of recidivism among habitual offenders and the need for and/or wording of a widely supported definition of bankruptcy fraud and habitual offenders. Efforts should also be made to share information more effectively between parties so that existing knowledge and information can be better exchanged and used. This could help to better embed and reinforce the subject-oriented approach. In addition, informal meetings can contribute to a more integrated approach. Finally, a broader use of available Chamber of Commerce information as well as the extension of the Bankruptcy Liquidator Guarantee Scheme could contribute to a more effective approach.