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# THE COMMENCEMENT OF BANK INSOLVENCIES IN CHINA: PROBLEMS AND PROSPECTS

Wang Xin\*

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### *Abstract*

*This article is the first study investigating the commencement of bank insolvencies after the collapse of Baoshang Bank. It appears that the Chinese Enterprise Bankruptcy Law somewhat fails to resolve bank insolvencies adequately. Regarding the Chinese approach, the normal bankruptcy law de facto serves as part of the regulatory tools in ending the existence of insolvent banks in procedural rather than fulfilling the real insolvency objectives. This article also identifies the two-stage solution for tackling bank insolvencies in China. During the first stage, regulatory authorities take administrative measures to prevent banks from collapsing. The second stage involves distributing assets among creditors and compensating depositors. These processes are both under the supervision of the regulatory authorities. According to statistics, it is very difficult for a troubled bank that already meets the general insolvency standard to enter the formal court-based insolvency procedure. In addition, whether the rescue process is a necessary pre-procedure for every bank insolvency remains controversial due to the inadequacy of laws. Indeed, there are many obstacles to the commencement of the insolvency procedure. This article calls for a more reasonable rule for the commencement of Chinese bank insolvency to promote fairness and efficiency.*

*Keywords:* bank insolvencies, commencement, insolvency requirements, insolvency applicants

### I. INTRODUCTION

A major problem of the bank insolvency regime in China is the difficulty of commencement, but little literature has shed light on this. CNKI (short for China National Knowledge Infrastructure), the largest database in China, only has a few articles that address “the commencement of bank insolvencies (*Yin Hang Po Chan Qi Dong*)”.<sup>1</sup> Some focus on a specific point of the issue of commencement.<sup>2</sup> For example, Wang and Chen investigate the parties who are

<sup>1</sup> See Wu Min (吴敏), *Woguo Shangye Yinhang Pochan Yuanyin de Falü Guiding Yanjiu* (我国商业银行破产原因的法律规定研究) [Study on the Legal Provisions of the Bankruptcy Causes of Commercial Banks in China], 3 JIANGHUAI LUNTAN (江淮论坛) [JIANGHUAI F.] 44 (2006); Liu Wenli (刘雯丽), *Lun Woguo Shangye Yinhang Pochan Yuanyin Zhidu* (论我国商业银行破产原因制度) [The Discussion of the Reasons for Insolvency System of Commercial Banks of China] (2020) (Ph.D. Dissertation, Jilin University, China) (CNKI).

<sup>2</sup> See Huang Zhiling (黄志凌), *Wenti Yinhang de Panduan yu Pochan Zaoqi Ganyu Jizhi* (问题银行的判断与破产早期干预机制) [Recognition of Troubled Banks and Early Intervention Mechanism of Bankruptcy], 7 JINRONG YANJIU (金融研究) [FIN. STUDY] 45(2015).

entitled to file for bank insolvency cases.<sup>3</sup> However, many are keen on the overview issue of the bank insolvency regime. For example, Wu and Lin discuss a future mechanism of banking administration or reorganization;<sup>4</sup> Su examines the whole bank resolution regime from a perspective of comparative study;<sup>5</sup> Kong evaluates the Chinese banking insolvency regime in his monograph, *New Bank Insolvency Law for China and Europe*;<sup>6</sup> Kong, Ba, and many other scholars focus on the future legal framework of the banking resolution regime in China.<sup>7</sup>

This article will fill the gap in the field by examining the commencement process of bank insolvencies in China. It will also provide policy recommendations based on the practice of other jurisdictions. A comparative perspective reveals how different jurisdictions set forth similar conditions for regulatory authorities.<sup>8</sup> For example, the initiation factors of banking insolvency in China are similar to Article 32 of the *Bank Recovery and Resolution Directive* (BRRD) of the European Union. When the troubled institution is failing or likely to fail and there is no reasonable measure that would prevent the failure within a limited time, to safeguard the public interest, the authorities could take the resolution action dealing with the troubled institution.<sup>9</sup> Moreover, the United Kingdom and China have similar legal frameworks, both, in theory, being court-based bank insolvency regimes. There is also a degree of resemblance between the Chinese and American approaches. For example, both countries delegate administrative regulators to take early, speedy, broad, and decisive actions when banks are failing or likely to fail, so

<sup>3</sup> See Wang Feimin (王斐民) & Chen Jing (陈婧), *Lun Shangye Yinhan Pochan de Shenqingquan Ren* (论商业银行破产的申请权人) [*The Applicants Standing for Commercial Banks' Insolvency*], 9 ZHENGZHI YU FALÜ (政治与法律) [POLITICS & LAW] 22 (2008).

<sup>4</sup> See Wu Lintao (吴锦涛) & Lin Xiuqin (林秀芹), *Lun Woguo Shangye Yinhang Pochan Chongzheng Zhidu de Goujian* (论我国商业银行破产重整制度的构建) [*Establishing the Reorganisation Regime of Banking Insolvency*] 1 XIAMEN DAXUE XUEBAO (ZHEXUE SHEHUI KEXUE BAN) (厦门大学学报(哲学社会科学版)) [XIAMEN U.J. (PHIL. & SOC. SCI. EDITION)] 149 (2013).

<sup>5</sup> See Su Jieche (苏洁澈), *Yingmei Yinhang Pochanfa Shuping: Yi Yinhang Teshu Pochan Zhidu Wei Zhongxin* (英美银行破产法述评——以银行特殊破产制度为中心) [*The Evaluation on UK and US Bank Insolvency Laws: Focusing on Special Bank Resolution Regime*], 2 HUANQIU FAXUE PINGLUN (环球法律评论) [GLOBAL L. R.] 93 (2013).

<sup>6</sup> See KONG QINGJIANG, *NEW BANK INSOLVENCY LAW FOR CHINA AND EUROPE*, VOL.1: CHINA (Eleven International Publishing 2017).

<sup>7</sup> See Ba Yüxi (巴于茜), *Guanyü Woguo Shangye Yinhang Pochan Falü Zhudu de Tanxi* (关于我国商业银行破产法律制度的探析) [*Exploring the Chinese Banking Insolvency Regime*], 21 FAZHÌ YÜ SHEHUI (法制与社会) [L. & SOCIETY] 45(2020).

<sup>8</sup> See SOPHIE BUCKINGHAM, SVETLANA ATANASOVA, SIMONA FRAZZANI & NICOLAS VÉRON, *STUDY ON THE DIFFERENCES BETWEEN BANK INSOLVENCY LAWS AND ON THEIR POTENTIAL HARMONISATION: FINAL REPORT 26* (Publ'ns Off. the Eur. Union eds., 2019).

<sup>9</sup> See Bank Recovery and Resolution Directive (BRRD), Directive 2014/59/EU of the European Parliament and of the Council, art. 32(1), 2014 OJ (L 173) 190, 249; *Yinhangye Jiandu Guanli Fa* (银行业监督管理法) [Banking Supervision Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 27, 2003, effective Feb. 1, 2004, amended Oct. 31, 2006), arts. 38 and 39, (Chinalawinfo); *Qiye Pochan Fa* (企业破产法) [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), art. 134, (Chinalawinfo).

that credit and liquidity losses of depositors and other creditors are reduced to the minimum.<sup>10</sup> Given that China's banking insolvency rules require further revision, the Anglo-American approach serves as a model to learn from.

This article consists of seven parts to analyze the Chinese bank insolvency regime. After this brief introduction, the article reviews the background of the whole banking sector and provides an overview of the initiation of the bank insolvency procedure. After that, part three discusses the grounds for banking insolvencies, and part four focuses on the applicants standing for insolvency. Both parts address specific regulations on the initiation of a bank insolvency procedure in court and analyze bank insolvency cases in China. In addition to key regulatory actions, part three and part four also examine how a bank can be placed into a court-centered insolvency proceeding. Part five identifies two main obstacles to the commencement of bank insolvencies. Finally, the sixth part offers some policy recommendations; and then, there is a conclusion.

The definitions of key terms are as follows. The term "insolvency" is used in a narrow sense in this article. It refers to the commencement point of insolvency that the court issue the insolvency order. The term "commencement" means the beginning of insolvency; the commencement process generally refers to an insolvent bank obtaining insolvency permission from the banking regulators and filing for insolvency to the court. The term "resolution" refers to a solution regime providing regulatory authorities with tools and powers to protect depositors, taxpayers, financial stability, and the whole economy.<sup>11</sup> It includes both resolution tools and the proceedings under the Bankruptcy Law and the Law on Commercial Banks. *Enterprise Bankruptcy Law 2006* is an official translation by the Chinese government, but translated in the "American" way, so "bankruptcy" here is equivalent to "insolvency" in British law. Similarly, the words "liquidation" and "winding up" are also interchangeable.

## II. THE BACKGROUND OF THE BANKING SECTOR AND INSOLVENCIES IN CHINA

The early period of the banking sector in China was regulated under the framework of the socialist planned economy. After the establishment of the People's Republic of China in 1949, the overall banking sector in mainland China was nationalized while most of the previous foreign banks were forced out.<sup>12</sup> The central government guided banks to channel finance to state-owned enterprises (SOEs), which underpinned the national economy. Namely, the

<sup>10</sup> See Robert R. Bliss & George G. Kaufman, *US Corporate and Bank Insolvency Regimes: An Economic Comparison and Evaluation* 10 (Federal Reserve Bank of Chicago Working Paper No. 1/2006), <https://www.chicagofed.org/publications/working-papers/2006/wp-01>; And also *supra* note 5 at 109.

<sup>11</sup> See Banking Act 2009, p. 1, c. 3, § 4 (UK), <https://www.legislation.gov.uk/ukpga/2009/1/section/4>.

<sup>12</sup> See Catherine R. Schenk & Emmanuel Mourlon-Druol, *Bank Regulation and Supervision*, in *THE OXFORD HANDBOOK OF BANKING AND FINANCIAL HISTORY* 412, 422 (Youssef Cassis, Catherine R. Schenk & Richard S. Grossman eds., 2016).

activities of banking were conducted by national economic rather than in response to market forces. There was a close connection between the state, the national economy, and the banking system, and then a bank-centered economic model emerged. The transition to a more market-based economy was the product of Deng Xiaoping's Opening Policy Reform in 1978, but the banking sector remained strictly under state control. With the promulgation of a series of laws in 1995,<sup>13</sup> the regulatory framework of China's banking sector was established. In 1995, the People's Bank of China (PBOC) was legally confirmed as the central bank<sup>14</sup> and continued to serve as the banking regulatory authority until China Banking Regulatory Commission (CBRC)<sup>15</sup> came into existence as the banking regulatory authority in 2003.<sup>16</sup> Nowadays, the banking and financial system is reformed and diversified under Xi Jinping Thought on Socialism with Chinese characteristics for a New Era, but it is still full of challenges and uncertainties.<sup>17</sup> It is worth noting that while the government embraces itself to an opening market, the Chinese economy adheres to the principle of socialism and supports public ownership in theory.<sup>18</sup> Hence, it is not easy for banks, especially state-owned or government-linked ones, which are representatives of socialism or public ownership, to enter an insolvency proceeding due to state protection.

#### A. *The Development of the Banking Sector in China*

China's banking sector has undergone major changes, closely following the changes in the nation's overall economic development, but issues of banking regulations have been exposed in the meantime. In comparison with the Anglo-American approach, the Chinese banking sector is highly protective. On the one hand, in most cases, banks in China, especially state-owned or state-controlled banks, had been treated as policy banks that execute state policy to support the economy over a long period.<sup>19</sup> On the other hand, due to the strategic development of a resilient domestic financial system, the government

<sup>13</sup> Law of the People's Republic of China on Commercial Banks was firstly promulgated in 1995 and then amended twice in 2003 and 2015 respectively; Law on the People's Bank of China was firstly promulgated in 1995 and then amended in 2003.

<sup>14</sup> See *Zhongguo Renmin Yinhang Fa* (中国人民银行法) [Law on the People's Bank of China] (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 18, 1995, effective Mar. 18, 1995, amended Dec. 27, 2003), art. 2, (Chinalawinfo).

<sup>15</sup> China Banking Regulatory Commission (CBRC) was set up in 2003; In 2018, CBRC merged with China Insurance Regulatory Commission (CIRC) to China Banking and Insurance Regulatory Commission (CBIRC).

<sup>16</sup> Law of People's Republic of China on Regulation and Supervision over the Banking Industry was firstly enacted in 2003 and amended once in 2006.

<sup>17</sup> See Zhang Yu (张宇), *Xi Jinping Guanyu Jingji Tizhi Gaige Xinsixiang* (习近平关于经济体制改革的新时代中国特色社会主义思想) [*Xi Jinping's New Thoughts on Economic System Reform*], CPC NEWS (July 19, 2016), <http://theory.people.com.cn/n1/2016/0719/c40531-28565264.html>.

<sup>18</sup> See *XIANFA* (宪法) [Constitution of People's Republic of China], art. 6 (promulgated by the Nat'l People's Cong., Dec. 4, 1982, effective Dec. 4, 1982, amended Mar. 11, 2018), CLI.1.311950 (Chinalawinfo).

<sup>19</sup> See Mark Hsiao, *Deposit Insurance Scheme as the Final Destination-Mapping the Financial Market*, 26 J. INT'L BANKING L. & REG. 538, 538 (2011).

keeps protecting banks from failing, although such protections may lead to moral hazard.<sup>20</sup> The relation between the supervision of a safety net and the bank resolution dominates the authorities' decision-making process. For the government, it is important to balance different policy considerations, economic development, the resilience of the financial system, and rising risks in the banking sector as a result of the state's overprotection. That also explains why initiating the bank insolvency would be such a prudential decision. The development of the Chinese banking sector provides an opportunity to evaluate the state backup for banks from a historical perspective, thus shedding light on regulators' caution over the commencement of bank insolvency procedure.

Between 1950 and 1978, the People's Bank of China (PBOC) was the dominating bank in China and acted as both the central bank and a commercial bank.<sup>21</sup> All other deposit-taking banks within the nation were branches of the PBOC.<sup>22</sup> Against the background of the socialist planned economy, the bank business kept changing because the Communist Party's policies varied in different periods.<sup>23</sup> Hence, some critics conclude that there was no banking industry or banking system during this period, because all activities of banks at that time were strictly controlled by governments, and competition between banks was impossible.<sup>24</sup>

Since 1978, the banking industry has begun developing rapidly and overall bank deposits have increased dramatically. By the end of 1984, the dominance of four state-owned megabanks, the Bank of China, China Construction Bank, Agricultural Bank of China, and Industrial and Commercial Bank of China, were established.<sup>25</sup> In 1987, the Bank of Communications, one of the oldest state-owned banks in China, was restructured to be the first joint-stock commercial bank. In 1992, Shenzhen Development Bank became the first listed bank in mainland China, although the issued shares to public investors were restricted in order to maintain the state's control.<sup>26</sup> In 1994, three policy banks, China Agricultural Development Bank, China Development Bank, and China Import and Export Bank, were established to supply tailored financial services to different sectors in a soaring economy. In 1996, one year after the enactment

<sup>20</sup> See Dayong Zhang et al., *Non-performing Loans, Moral Hazard and Regulation of the Chinese Commercial Banking System*, 63 J. BANKING & FIN. 48, 60 (2016).

<sup>21</sup> See Hsiao, *supra* note 19.

<sup>22</sup> See Qingjiang Kong & Yinghui Sun, *China*, in CRISIS MANAGEMENT IN THE BANKING SECTOR 426 (Matthias Haentjens & Bob Wessels eds., 2016).

<sup>23</sup> See Wang Guogang (王国刚), *Zhongguo Yinhangye Qishi Nian: Jianyao Licheng, Zhuyao Tedian he Lishi Jingyan* (中国银行业70年:简要历程、主要特点和历史经验) [70 Years of Banking Sector in China: Development, Characters, and Experience], 7 GUANLI SHIJI (管理世界) [MGMT. WORLD] 15, 17 (2019).

<sup>24</sup> See Lu Minfeng (陆岷峰) & Zhou Junyu (周军煜), *Zhongguo Yinhangye Qishi Nian Fazhan Zuji Huigu Ji Weilai Qushi Yupan* (中国银行业七十年发展足迹回顾及未来趋势研判) [A Review of The Development Footprint of Chinese Banking Industry Over the Past 70 Years and A Study of Future Trends], 4 JINAN DAXUE XUEBAO (SHEHUI KEXUE BAN) (济南大学学报(社会科学版)) [J.U. JINAN (SOC. SCI. EDITION)] 5, 8 (2019).

<sup>25</sup> See Hsiao, *supra* note 19.

<sup>26</sup> See Schenk & Murlon-Druol, *supra* note 12, at 422.

of the Law on Commercial Banks, Min Sheng Bank was set up as the first bank in China that had a majority of non-state shareholders.

However, most banks remained controlled by the state. Since managers of these banks were appointed by the government and banks conducted businesses under the authority's directions, these banks never operated as independent entities. In the 80s, banks were arguably treated as nothing but government agencies responsible for financing and supporting SOEs.<sup>27</sup> This affinity also affected SOEs' behavior, eventually leading to chronic loan quality issues. As the Chinese economy gradually opened up during the 1980s and 1990s, the problems of the inefficiency of SOEs and loan quality issues of banks were exposed. Restructuring SOEs' businesses required sufficient and sustained flows of capital, which were provided by banks following state policies. As a result, in 2000, almost a third of overall bank assets were non-performing loans (NPLs)<sup>28</sup> and NPLs in the top four largest banks amounted to nearly a quarter of assets.<sup>29</sup> Some even argued that these big four banks would be deemed insolvent under accounting standards.<sup>30</sup> In fact, due to the strong backup by the state, although many banks incurred losses and accumulated a large amount of NPLs, not a single bank declared bankruptcy.<sup>31</sup> Authorities preferred to replace the managers of misbehaving banks as if a change in leadership would automatically resolve all the problems. Unfortunately, the fundamental problem caused by the socialist planned banking system was never resolved. The government continued to bear the losses of banks because the majority of loans were made to SOEs.<sup>32</sup> Research estimates that the cost of cleaning up NPLs of SOEs could constitute as much as 22 percent of the nation's GDP in the late 90s.<sup>33</sup> Another problem was that the government supported banks through the bailout scheme largely by printing more money, which led to devastating inflation during the 1980s and 1990s.<sup>34</sup> In response to the existing problems, the initial reform of the banking industry focused on the establishment of independent banks from the government to avoid the knock-on effect from distressed SOEs to the banks.<sup>35</sup>

During the 1990s, the banking sector went through a two-step reform. The first step was to separate financial services from the government by legislation.

<sup>27</sup> See Wang Guogang, *supra* note 23, at 18.

<sup>28</sup> See Schenk & Mourlon-Druol, *supra* note 12, at 422.

<sup>29</sup> See Alfreda V. Davis et al., *China's Banking System*, 2 BUS. & PUB. ADMIN. STUD. 34, 34 (2007).

<sup>30</sup> See *id.*

<sup>31</sup> See He Chang (何畅), *Xianxing Shangye Yinhang Pochan Falü Zhidu Cunzai De Quexian Ji Wanshan Duice* (现行商业银行破产法律制度存在的缺陷及完善对策) [*Loopholes in the Present Bankruptcy Law System Regarding Commercial Banks and Its Solutions*], 12 JINRONG LUNTAN (金融论坛) [FIN. F.] 21, 25 (2003).

<sup>32</sup> See Richard Podpiera, *Progress in China's Banking Sector Reform: Has Bank Behaviour Changed?* (International Monetary Fund Working Paper No. WP/06/71, 2006), <https://www.imf.org/external/pubs/ft/wp/2006/wp0671.pdf>.

<sup>33</sup> See Guonan Ma, *Sharing China's Bank Restructuring Bill*, 3 CHINA & WORLD ECON. 19, 36 (2006).

<sup>34</sup> See Richard Podpiera, *supra* note 32.

<sup>35</sup> See Lu & Zhou, *supra* note 24, at 9.

The first banking legislation, the *Law of the People's Republic of China on Commercial Banks*, was promulgated in 1995, demonstrating the Chinese authorities' determination to build a functioning regulatory framework, although most of the articles commentators argue were ambiguous.<sup>36</sup> In 1998, the State Council, China's central government, established the Central Financial Work Committee.<sup>37</sup> The committee took the power of supervising state-owned financial institutions from local governments. The goal was to weaken local governments' administrative intervention in financial work, especially in granting loans according to state policy to state-owned entities.<sup>38</sup> Although banks and other financial institutions were separated from the government by an institutional arrangement, they still received government protection. Only a few provisions in the Law on Commercial Banks mentioned the insolvency mechanism since bank insolvency was not a priority at that moment and the priority of the government at that time was to keep a resilient financial system and to prevent troubled banks from collapsing.<sup>39</sup> Given this, the second step of the reform during the 1990s focused on the NPLs. In 1999, to improve the balance sheets of commercial banks, the Treasury invested RMB10 billion to set up four Asset Management Companies, Cinda, Huarong, Great Wall, and Orient Asset Management Corporation, to look after NPLs of Chinese banks, especially those of the big four which at the same time happened to be the top four banks in the world.<sup>40</sup>

In 2001, China joined the World Trade Organization (WTO) and promised to open up the Chinese banking system to the international market, allowing foreign and private investors to hold equities in Chinese banks. But there remained many problems, such as risk management and inadequate market disciplines.<sup>41</sup> Banking regulators responded to the WTO agreement by announcing the enactment of *Guidance of the China's Banking Supervision and Management of the Committee on the Corporation Governance Reform and Supervision of Bank of China and China Construction Bank* in 2004. The *Guidance* encouraged state-owned banks to restructure as joint-stock banks.<sup>42</sup>

<sup>36</sup> See Dong Ximiao (董希淼), *Shangye Yinhang Fa Xiugai de Yiyi* (商业银行法修改的意义) [Significance of Amendments to Commercial Banking Law], 21 ZHONGGUO JINRONG (中国金融) [CHINA FIN.] 54, 54 (2020).

<sup>37</sup> In 2003, Central Financial Work Committee was revoked. In the same year, China Banking Regulatory Commission (CBRC) was legally set up by the central government. In 2018, the merger of CBRC and CIRC constitutes China Banking and Insurance Regulatory Commission (CBIRC).

<sup>38</sup> See Wang Yongli (王永利), *Baoshang Yinhang Pochan Qingsuan Juyou Zhongyao Biaogan Yiyi* (包商银行破产清算具有重要标杆意义) [The Liquidation of the Baoshang Bank is a Milestone in Bank Insolvency], ZHONGGUO YINHANG BAOXIAN BAO WANG (中国银行保险报网) [CHINA BANKING & INS. NEWS ONLINE] (Aug. 17, 2020), [http://pl.sinoin.com/2020-08/17/content\\_358490.htm](http://pl.sinoin.com/2020-08/17/content_358490.htm).

<sup>39</sup> See Zhang, *supra* note 20 at 60.

<sup>40</sup> See *id.*

<sup>41</sup> See Schenk & Mourlon-Druol, *supra* note 12.

<sup>42</sup> See Zhongguo Yinhangye Jiandu Guanli Weiyuanhui Guanyu Zhongguo Yinhang Zhongguo Jianshe Yinhang Gongsi Zhili Gaige yu Jianguan Zhiyin (中国银行业监督管理委员会关于中国银行、中国建设银行公司治理改革与监管指引) [Guidance of the China's Banking Supervision and Management of the Committee on the Corporation Governance Reform and Supervision of Bank of China and China Construction



In addition, the *Guidance* showed a positive attitude towards banking reform, calling for strengthening capital adequacy from foreign investment and learning the best practice of corporate governance as well as management skills from foreign entities.<sup>43</sup> However, foreign investors were tightly regulated. For example, the ownership of any individual foreign investor was capped at 20 percent and only large foreign banks would qualify as foreign investors. These restraints were finally lifted in 2019.<sup>44</sup> As result, in the last two decades, foreign banks have increased rapidly in total assets and investment in the Chinese banking sector, but the amount of foreign banks is still small. By the end of 2020, there were 4,607 banks and banking financial institutions and merely 41 wholly-owned subsidiaries of foreign banks.<sup>45</sup> Thus, the whole picture has not been changed too much. Most of the banks in China remain state-controlled and are protected by the government to some degree. This gives rise to the question of insufficient competition in the banking sector. Currently, the big four Chinese banks lend nearly half of loans in China and this oligopolistic structure may negatively affect non-state-owned banks.<sup>46</sup>

Therefore, such a rapid development of the banking sector calls for a reasonable banking regulation system. Indeed, China has a set of banking regulatory and resolution regime that allows insolvent banks to exit the market in an orderly fashion, but it still requires time and effort to establish the optimal institutional structure.

### B. *The Practice of Bank Insolvencies in China*

An effective legal framework should be able to handle failing banks. Worldwide, some countries, such as the United States, have developed a bank-specific insolvency procedure known as the free-standing regime; others deal with bank insolvency cases under general corporate insolvency law with amended specific provisions and so-called modified insolvency regimes, like the United Kingdom, which updated its laws for the orderly management of distressed banks in the aftermath of the Global Financial Crisis.<sup>47</sup> It is almost a consensus that the ordinary corporate insolvency regime is inadequate for bank

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Bank] (promulgated by China Banking Regulatory Commission, Mar. 11, 2004, effective Mar. 11, 2004), (Chinalawinfo).

<sup>43</sup> See *id.*

<sup>44</sup> See Yang Zhijin (杨志锦) & Zhou Xiangyue (周享玥), *Waizi Jinrong Jigou Chigu Ruhe Tupao 20%?* (外资金融机构持股限制如何突破20%?) [How to break through the 20% shareholding limit of foreign financial institutions?], 21 JINGJI WANG (21 经济网) [21TH CENTURY ECON. NEWS] (July 8, 2019), <https://www.21jingji.com/article/20190703/herald/d72d9f8207eea15ef3e88053e8a275ef.html>.

<sup>45</sup> See Zhang Yao (张瑶), *2020 Nian Zhongguo Waizi Yinhang Fazhan Licheng, Jigou Shuliang, Yingli Shuiping he Buliang Daikuan Tongji* (2020年中国外资银行发展历程、机构数量、盈利水平及不良贷款情况统计) [Statistics of the Foreign Banks in China in 2020: Development, Number, Profitability and NPLs], CHANYE XINXI WANG (产业信息网) [INDUS. INFO. ONLINE] (April 22, 2021), <https://www.chyxx.com/industry/202104/946824.html>.

<sup>46</sup> See Sara Hsu, *China's Banking Sector as the Foundation of Financial Reform*, 3 ASIA & THE PACIFIC POL'Y STUD. 244, 246 (2016).

<sup>47</sup> See BUCKINGHAM ET AL., *supra* note 8, at 13.

insolvency.<sup>48</sup> However, it seems that China does not keep up with the pace of the international reform of the banking resolution. Chinese banking institutions are still subject to the *Enterprise Bankruptcy Law* and there is no special statute for bank insolvencies.<sup>49</sup>

The practice of bank insolvencies in China has some unique features due to the relationship between banks and the state. Despite the change from the socialist planned economy to the socialist style of the capitalist market, the idea that banks are unofficial government agencies remains unchanged, because banks are still being used for some government purposes.<sup>50</sup> For example, Chinese banks make gigantic loans to local governments in response to the state's economic stimulus plan.<sup>51</sup> SOEs enjoy much easier access to bank loans compared to non-SOEs'.<sup>52</sup> Evidently, under Chinese socialism, banks are always regarded as policy institutions that execute state policies to support the economy. Furthermore, if the government's priority is to set up a resilient domestic financial system, regulators will try to avoid any possible negative effects of bank insolvency. In view of this, the public gradually forms an opinion of relating the bank's reputation with the state's reputation.<sup>53</sup> However, such circumstance leads to a serious problem. The issue of the fiscal deficit in banks is increasing because of the financial backup by the government.<sup>54</sup> Nevertheless, for those who do not realize that the government backing up is a serious problem, it is inconceivable that a bank can go bankrupt.

In addition, some politicians still believe that the bank insolvency regulation is under the supervisory authority's control. There would be no large-scale bank insolvency cases in the future and the bankruptcy of some small banks is manageable by the government.<sup>55</sup> In practice, the government does use administrative means to guide the whole insolvency process, which shows the superiority of socialism. As a result, although the rules of bank

<sup>48</sup> See PATRIZIA BAUDINO ET AL., HOW TO MANAGE FAILURES OF NON-SYSTEMIC BANKS: A REVIEW OF COUNTRY PRACTICES (Financial Stability Institute Insights on Policy Implementation No 10, October 2018).

<sup>49</sup> See Enterprise Bankruptcy Law 2006, art. 134.

<sup>50</sup> See He, *supra* note 31, at 25.

<sup>51</sup> See Kenneth Rapoza, *IMF Warns China on Rising Government Debt*, FORBES (May 29, 2013), <https://www.forbes.com/sites/kenrapoza/2013/05/29/imf-warns-china-on-rising-government-debt/>.

<sup>52</sup> See KONG, *supra* note 6, at 15.

<sup>53</sup> See Li Shuguang (李曙光), *Tuijin Qiye Pochan Fa Xiuding, Jianquan Jinrong Jigou Pochan Zhidu* (推进企业破产法修订, 健全金融机构破产制度) [*Promote the Revision of the EBL2006 and Improve Financial Institution Insolvency Regime*], 2 QINGHUA JINRONG PINGLUN (清华金融评论) [TSINGHUA FIN. REV.] 19, 21 (2020).

<sup>54</sup> See, *id.*

<sup>55</sup> See Wu Yu (吴雨), *Baoshang Yinhang Bei Jieguan Shi Ge'an, Dangqian Jinrong Fengxian Zongti Kekong* — Zhongguo Renmin Yinhang Youguan Fuzeren Da Jizhe Wen (包商银行被接管是个难案, 当前金融风险总体可控——中国人民银行有关负责人答记者问) [*Taking over the Management of Baoshang Bank is Just an Individual Case and the Current Financial System is Safe and Well-Controlled—Response Inquiries by PBOC*], XINHUA WANG (新华网) [XINHUA NEWS] (June 2, 2019), [http://www.xinhuanet.com/fortune/2019-06/02/c\\_1124574561.htm](http://www.xinhuanet.com/fortune/2019-06/02/c_1124574561.htm) (last visited Mar. 12, 2021).

insolvency are loose and they have not been much improved in recent years, the authority simply lacks the sufficient motivation to change the law.<sup>56</sup>

However, academia doesn't share officials' optimism. One of the key reasons is that it is impossible to rescue all troubled banks and pay off all creditors through fiscal means, so bank insolvencies are inevitable. Indeed, the government is doing its best to avoid bank insolvencies. In previous bank insolvency cases, insolvent banks and other financial institutions always received bailouts from the government. For example, when Hainan Development Bank faced insolvency in 1998, the province government generously promised to pay creditors.<sup>57</sup> Some critics immediately pointed out that it was not acceptable to use taxpayers' money to do so.<sup>58</sup> For this individual case, the Hainan government maintained that social and financial stability should prevail, but in the long term, there is a negative influence. Unequal treatment of creditors and ambiguity of legislation become a source of social unrest.<sup>59</sup> The government's emphasis on stability also impairs market discipline and falsely encourages inordinate risk-taking by banks.<sup>60</sup>

After the enforcement of the Chinese *Enterprise Bankruptcy Law* in 2006, the commencement of bank insolvencies becomes possible. Banks can file for bankruptcy according to Article 134 of the *Enterprise Bankruptcy Law*. This is a landmark provision for the banking insolvency regime.<sup>61</sup> However, rules of implementation measures for the bankruptcy of financial institutions have not been promulgated yet. The delay leads to many difficulties in practice. As the number of bank failures increases, the absence of provisions grows into a much more serious problem. If there is no clear legal basis, it will be very cautious for the court to initiate the insolvency procedure. Subsequently, if the insolvency procedure cannot be initiated, the payment of creditors would be postponed. If creditors have no way to solve the problem through judicial means, then they may use other methods to defend their rights.

The de facto bank insolvency cases could be summarised as follows. Generally speaking, the number of declared insolvency cases is less, but the number of banks which encountered insolvency problems is quite large. In fact, since 1949, only five deposit-taking banks have been declared bankrupt by the government to the public, including Hainan Development Bank (in 1998), Hebei Suning Shangcun Credit Cooperative (in 2011), Inner Mongolia-Based

<sup>56</sup> See Chen Xiaohong (陈夏红), *Jinrong Jigou Pochan Tiaoli Heyi Chichi Bu Banbu* (金融机构破产条例何以迟迟不颁布?) [Why has the Bankruptcy Rules of Financial Institutions Not Been Promulgated?], LEGAL DAILY (April 4, 2020), [http://www.legaldaily.com.cn/fxjy/content/2018-04/04/content\\_7514494.htm](http://www.legaldaily.com.cn/fxjy/content/2018-04/04/content_7514494.htm) (last visited Mar. 12, 2021).

<sup>57</sup> See Wang Nan (王楠), *Woguo Yinhang Pochan Falv Zhidu Wenti Yanjiu* (我国银行破产法律制度问题研究) [A Study on Chinese Bank Insolvency Law], 4 FAXUE JIA (法学家) [THE JURIST] 77, 78 (2007).

<sup>58</sup> See Guonan Ma, *Who Pays China's Bank Restructuring Bill?*, 6 ASIAN ECON. PAPERS 46 (2007).

<sup>59</sup> See Kong & Sun, *supra* note 22, at 430.

<sup>60</sup> See Umlauf S. Thomas, *The Paradoxical Genesis of Too-Big-To-Fail: How Distrust Towards Big Banks Led to TBTF*, 3 J. GOVERNANCE & REG. 28, 30 (2014).

<sup>61</sup> See Enterprise Bankruptcy Law 2006, art. 134.

Baoshang Bank (in 2019), Liaoyang Nongshang Bank (2022), and Liaoning Taizihe Rural Bank (2022).<sup>62</sup> Moreover, there have been many distressed small banks (credit cooperatives) that were closed by the government.<sup>63</sup> These small banks could not be classified as bank insolvencies because they did not file for bankruptcy.

Notably, Hainan Development Bank did not enter the court-based insolvency procedure since the failure of Hainan Development Bank happened prior to the enforcement of the general insolvency law, *Enterprise Bankruptcy Law 2006*. As the result, only four banks entered the judicial insolvency proceeding. After 2006, the first bank liquidation case took place in 2011 (see Table 1 below). Hebei Suning Shangcun Credit Cooperative closed the business in 2001 and filed for liquidation in 2011. The permission for liquidation lasted for ten years. The authority dealt with the case extremely carefully since there was no law to apply before the year 2006. In 2011, this small bank finally met all requirements set by the government and filed for liquidation with the regulatory authorities' permission. Then, on 17<sup>th</sup> November 2020, Baoshang Bank applied to the court for liquidation on the grounds that it could not pay off the due debts while its assets were not enough to pay off all the debts (see Table 1 below).<sup>64</sup> After that, it was ordered to be wound up and complete the winding up procedure on 19<sup>th</sup> August 2021.<sup>65</sup>

Besides, many banks did not enter the banking insolvency process but may meet or likely meet the general insolvency standard, which is listed in Table 2. It is worth mentioning that table 2 only includes the cases of the last three years, from 2019 to 2022. In Table 2, five banks faced serious liquidity troubles and have been temporarily closed by the government without initiating either the judicial insolvency procedure or the deposit guarantee scheme; six banks

<sup>62</sup> See *Sanjia Yinhang Yijing Daobi Zuigao Peifu Wushiwan Sizhong Qingkuang Yifen Bupei Guowai Nengpei Duoshao* (三家银行已经倒闭, 最高赔付五十万 四种情况一分不赔 国外能赔多少) [Three Banks Are Filed For Bankruptcy and the Highest Compensation Is Only RMB 500,000 with Four Exception Scenarios; How about the other jurisdictions? ], SINA FINANCE AND ECON. NEWS (新浪财经头条) (Sept. 12, 2020), <https://cj.sina.com.cn/articles/view/1568309232/5d7a7ff000100r8pd>; Li Yuan (李愿), *Baoshang Yinhang Zhihou You Liangjia Yinhang Jinru Pochan Chengxu: Fayuan Yi Caiding Shouli Pochan Qingsuan Shenqing* (包商银行之后又两家银行进入破产程序: 法院已裁定受理破产清算申请) [Another Two Banks Filed for Insolvency After the Failure of Baoshang: The Court Has Accepted Their Applications for Liquidation] 21 JINGJI WANG (21 经济网) [21<sup>ST</sup> CENTURY ECON. NEWS] (Aug. 26, 2022), <https://www.21jingji.com/article/20220826/herald/0de15550f92c312a6451ff0971535075.html>.

<sup>63</sup> See Lei Shunying (雷顺英), *Beihai Shi Shisi Jia Chengshi Xinyongshe Guanbi Qingsuan Liunian Yilai Baolu de Wenti Gei Dangqian Jinrong Jigou Fangfan he Huajie Qiyi Jinrong Fengxian de Qishi* (北海市十四家城市信用社关闭清算六年以来暴露的问题给当前金融机构防范和化解区域金融风险的启示) [Lessons for Financial Institutions to Prevent and Dissolve Regional Financial Risks — Fourteen Urban Credit Cooperatives in Beihai City Have Been Shut Down for Six Years], 11 GUANGXI JINRONG YANJIU (广西金融研究) [FIN. STUDY IN GUANGXI PROVINCE] 22, 22 (2004).

<sup>64</sup> See The First Intermediate People's Court of Beijing Municipality, *Verdict of the Acceptance of Filing for Insolvency of Baoshang Bank Co. Ltd.*, Nov. 23, 2020, <https://pccz.court.gov.cn/pcajxxw/pcgg/ggqx?id=A0DD1BE17A3F3F8A086F55462B5ADA28>.

<sup>65</sup> See The First Intermediate People's Court of Beijing Municipality, *Verdict of the Competition of Liquidation of Baoshang Bank Co. Ltd.*, Aug. 19, 2021 <<https://pccz.court.gov.cn/pcajxxw/pcgg/ggqx?id=173BC4DDB55F9708AFA064A6B1BE90A2>>.

entered the administrative restructuring process and five of them were merged into other banks.

TABLE 1. BANKS ENTERED THE COURT-BASED INSOLVENCY PROCEDURE IN CHINA FROM 2006 TO 2022

No.	Bank's Name	Scale	CBIRC Approval	Insolvency Entry	Completion Date	Court	Takeover Entry	Branch Acquirer
1	Liaoyang Nong Shang	Rural Bank	4/8/2022	26/8/2022	TBC	Shenyang Intermediate People's Court	2/7/2022	Shenyang Nongshang
2	Liaoning Taizihe	Rural Bank	3/8/2022	26/8/2022	TBC	Shenyang Intermediate People's Court	2/7/2022	Shenyang Nongshang
3	Baoshang	City Bank	23/11/2020	23/11/2020	19/8/2021	Beijing No.1 Intermediate People's Court	24/5/2019	Menghang; Huishang
4	Hebei Suning Shangcun	Rural Bank	2010 (specific date: TBC)	8/2011 (specific date: TBC)	2012 (specific date: TBC)	Cangzhou Intermediate People's Court	No (The bank has closed since 2001)	No

Source: Collected by the Author

TABLE 2: BANKS FACED LIQUIDITY PROBLEM OR LIKELY MEET INSOLVENCY STANDARD BUT NOT ENTERED THE JUDICIAL INSOLVENCY PROCEDURE IN CHINA FROM 2019 TO 2022

No.	Company	Scale	Issue/Reason	Date	Solution	Result
1	Yuzhou Xinminsheng	Rural Bank	Liquidity problem; now closed.	Since April 2022, these banks have been reported as troubled banks.	The local government (local CBIRC) paid depositors but not all depositors have been paid. <sup>66</sup>	Pending
2	Henan Shangcai Huimin	Rural Bank				
3	Zhecheng Huanghuai	Rural Bank				
4	Kaifeng	Rural Bank				

<sup>66</sup> See Hu Yanming (胡艳明), *Yüwan Wujia Cunzhen Yinhang Wufa Xianshang Quxian Beihou de Zhipian Shilian Zhiyi* (豫皖五家村镇银行“无法线上取现”背后的诈骗、失联之疑) [*The Fraud and Missing Contact of Banks: Five Rural Banks in Henan and Anhui Cannot Withdraw Cash from Online*], SINA FIN. (30 Apr. 30, 2022), [https://finance.sina.com.cn/money/bank/bank\\_hydt/2022-04-30/doc-imcwiwst4819919.shtml](https://finance.sina.com.cn/money/bank/bank_hydt/2022-04-30/doc-imcwiwst4819919.shtml). Hebei Suning Shangcun Nongxinshe Pochan Anjian Jinru Sifa Chengxu Yinqi Shehui Guanzhu (河北肃宁尚村农信社破产案进入司法程序引社会关注) [*Hebei Suning Shangcun Rural Credit Cooperative Bankruptcy Enters the Judicial Procedure Caused Much Attention*], PEOPLE'S DAILY ONLINE (19 Aug. 19, 2012), [http://news.jcrb.com/jxsw/201208/t20120819\\_929332.html](http://news.jcrb.com/jxsw/201208/t20120819_929332.html). Wang Mengjie (王

	Xindongfang					
5	Anhuisheng Guzhen Xinhuahe	Rural Bank				
6	Luoyang	City Bank	TBC	25/5/2022	Merged into Zhongyuan Bank <sup>67</sup>	Completed
7	Pingdingshan	City Bank				
8	Jiaozuo Zhonglv	City Bank				
9	Yingkou Yanhai	City Bank	TBC (Yingkou Yanhai Bank was reported bank run in November 2019)	30/9/2022	Merged into Liaoshen Bank <sup>68</sup>	Completed
10	Liaoyang	City Bank				
11	China Huarong Asset Management Corporation	Investment Bank (non- deposit taking)	Balance sheet problem Non-performing loans cause balance sheet and	First reported in April 2021	Recapitalisation (Five SOEs subscribed the Hua Rong's capital.) <sup>69</sup>	Pending
12	Jinzhou	City Bank	liquidity problems.	30/9/2020	Administration	Completed
13	Hengfeng	National Bank	Mismanagement	31/12/2019	Administration	Completed

Source: Collected by the Author

According to statistics, it is not difficult to conclude that some banks met the bankruptcy standard according to the *Enterprises Bankruptcy Law*, but did not enter the court-based insolvency process. For example, the *Enterprises Bankruptcy Law* includes the administration procedure, which is a rescue procedure designed for likely insolvent companies. It shares many similarities to the administrative reorganization means for banks. Hence, whether banks could apply the administration rules in the *Enterprises Bankruptcy Law* instead of the administrative reorganization process is an unanswered question. Otherwise, another unsolved issue is whether an insolvent bank could elect to

梦婕) & Li Hongxian (李弘晔), *Henan Xuchang Nongxinshe Fouren Cunzhe Zuofei Cheng Jiang Changhuan Quanbu Benjin* (河南许昌农信社否认存折作废 称将偿还全部本金) [*Henan Xuchang Rural Credit Cooperative Denied Partly Paid Debts and Said Will Pay All Principals to Creditors*], CHINA YOUTH DAILY (Aug. 9, 2012), [http://news.jcrb.com/jxsw/201208/t20120809\\_923297.html](http://news.jcrb.com/jxsw/201208/t20120809_923297.html).

<sup>67</sup> See Questions and Answers at the Press Conference of the Report of the China Banking and Insurance Regulatory Condition by the State Council Information Office (国务院新闻办就2022年上半年银行业保险业运行发展情况举行发布会) (July 21, 2022), [http://www.gov.cn/xinwen/2022-07/22/content\\_5702220.htm](http://www.gov.cn/xinwen/2022-07/22/content_5702220.htm).

<sup>68</sup> See *id.*

<sup>69</sup> See Kyungji Cho & Ameya Karve, *Red Lights Flashing in Credit Markets as Huarong Concern Grows*, BLOOMBERG UK (April 13, 2021), <https://www.bloomberg.com/news/articles/2021-04-13/a-gauge-of-asia-bond-risk-jumps-in-longest-streak-since-2018>; Ma Rong (马蓉), *Zhongguo Huarong Nianbao Nanchan Yin Danyou, Wanyi Jinkong Jitou Nan Pochan huo Jie Waiyuan Chongzu Huo Xinsheng* (中国华融年报难产引担忧, 万亿金控巨头难破产或借外援重组获新生) [*China Hua'ong's Annual Report Having Not Been Publicly Raised Concerns: It Is Difficult to Go Bankrupt While It May Be Rescued*], REUTERS (April 15, 2021), <https://www.reuters.com/article/china-huarong-result-report-delay-0415-idCNKBS2C202Q>.

use the administrative resolution tool or enter the judicial bank administration procedure.

Furthermore, the statistics shows that some banks were successfully rescued by different administrative resolution tools. Arguably, it seems that the authorities prefer rescuing a bank rather than winding it up. It is very prudential for banking regulators to initiate a court-based winding up procedure. On the contrary, rescue measures, such as administration/reorganization and the assumption of control of banks stipulated in the *Law on Commercial Banks* and the *Banking Supervision and Regulation* are more welcome by the authorities.<sup>70</sup> It is worth noting that the word “administration or reorganization” in this period is an administrative procedure led by the government, which is different from the court-based administration/reorganization stipulated in the *Enterprises Bankruptcy Law*. In insolvency law, the words “administration” and “reorganization” share the same meaning, but the word “administration” is a “British” expression whereas “reorganization” is an “American” expression.

However, the shift point from the rescue process to the court-based insolvency process is not clear at the moment, which gives large discretion to the authorities and causes more difficulties in the commencement of bank insolvencies. Furthermore, the absence of clear statutory provisions for banking resolution makes these cases more significant. These cases also illustrate the constraint of the current bank insolvency regime and show the gap between the law in text and in action, which will be discussed in the following parts.

### III. CRITERIA FOR INITIATING BANKING INSOLVENCY IN CHINA

Effective criteria for banking insolvency should be able to achieve the goal of allowing failed banks to quit the market orderly. From the international perspective, each country has its own set of rules for declaring bank insolvency but has similar objectives. As the Financial Stability Institute concludes, in most regimes, the grounds for bank insolvency are generally designed to “facilitate the timely opening of the proceeding”,<sup>71</sup> which goes beyond ordinary insolvency law since the commencement standard of banking resolution includes some “forward-looking grounds that the bank is likely to fail”.<sup>72</sup> However, there are many constraints to initiating the bank insolvency procedure in China. This part particularly examines the criteria for bank insolvencies in China and shows the banking insolvency standard in real bank insolvency cases.

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<sup>70</sup> See Law of the People’s Republic of China on Commercial Bank (2015); Law of the People’s Republic of China on Banking Supervision and Regulation (2006).

<sup>71</sup> See PATRIZIA BAUDINO ET AL., *supra* note 48, at 15.

<sup>72</sup> See *id.*

### A. Balance Sheet and Cash Flow Test

Generally speaking, the grounds for entering a corporate insolvency proceeding are normally based on “balance sheet insolvency”, where liabilities exceed assets, and on “cash flow insolvency”, where the bank is unable to pay its debts as they fall due.<sup>73</sup> This insolvency test is essential and common in many countries as well as in China, although different terminologies and expressions are described in different rules.<sup>74</sup>

The banking insolvency regime in China is subject to general insolvency law<sup>75</sup> along with some special provisions in banking laws.<sup>76</sup> The insolvency test is mainly described in Article 2 of the Chinese *Enterprise Bankruptcy Law 2006*, which stipulates that the grounds for opening an insolvency procedure should be “either the company is unable to pay its debts while the assets are not enough to pay off all debts, or the company is unable to pay its debts while it apparently lacks the ability to pay off its debts”.<sup>77</sup> Banks are also subject to this article but the commencement of bank insolvencies should be approved by regulators in advance.<sup>78</sup> In addition, another special provision related to the insolvency test of banks is Article 71 of the *Law on Commercial Banks 2015*, which states when a commercial bank is unable to pay its debts, after the approval of banking regulators, it can be declared insolvent by the court.<sup>79</sup> Nevertheless, it is worth mentioning that Article 71 of the *Law on Commercial Banks 2015* is slightly different from Article 2 of the *Enterprise Bankruptcy Law 2006*. Under Article 71, a bank only needs to meet the condition of being “unable to pay its debts”<sup>80</sup> to file for insolvency, without the requirements of neither “the assets of the bank are not enough to pay off all debts”<sup>81</sup> nor “the bank apparently lacks the ability to pay off its debts”<sup>82</sup>.

However, both Article 71 of the *Law on Commercial Banks 2015* and Article 2 of the *Enterprise Bankruptcy Law 2006* have some defects. For example, Article 71 of the *Law on Commercial Banks 2015* provides a basic threshold, which the banking insolvency may commence when the bank is unable to pay its obligations as they fall due.<sup>83</sup> Notably, the grounds for applying for bank insolvency stipulated in this provision only include “a bank

<sup>73</sup> See Vanessa Finch & David Milman, *Corporate Insolvency Law: Perspectives and Principles* 123 (3rd ed., Cambridge 2017).

<sup>74</sup> See Long (龙雨), *Lun Shangye Yinhang de Pochan Biaozhun* (论商业银行的破产标准) [*The Standards of the Commencement of Banking Insolvency*], 4 NANHUA DAXUE XUEBAO (南华大学学报) [J.U. SOUTH CHINA] 26, 28 (2007).

<sup>75</sup> See *Enterprise Bankruptcy Law 2006*.

<sup>76</sup> See *Law of the People's Republic of China on Commercial Bank 2015 & Banking Supervision Law 2006*.

<sup>77</sup> See *Enterprise Bankruptcy Law 2006*, art. 2.

<sup>78</sup> See *id.*, art. 134.

<sup>79</sup> See *Law of the People's Republic of China on Commercial Bank 2015*, art. 71.

<sup>80</sup> See *id.*

<sup>81</sup> See *Enterprise Bankruptcy Law 2006*, art. 2.

<sup>82</sup> See *id.*

<sup>83</sup> See *Law of the People's Republic of China on Commercial Bank 2015*, art. 71.



is unable to pay its debts' but without 'likely to become unable to pay its debt', which is different from the rules in the United Kingdom.<sup>84</sup> But in terms of the legislative form of insolvency grounds, both the United Kingdom and China use the method of direct enumeration to illustrate the grounds for applying for insolvency along with empowering the discretion of the regulatory authorities.<sup>85</sup> Moreover, it is not reasonable to use the "cash flow test" as the only reason for banking insolvency since many liquidity problems can be addressed through bail-out tools in most cases.<sup>86</sup> Regarding this, the words "with the consent of the regulatory authorities" are added in Article 71 to restrict the initiation of insolvency; but obtaining such permission and identifying the financial problem are not clarified in the statute, which makes this article rarely used in practice.<sup>87</sup>

For example, in the Inner-Mongolia Baoshang Bank (Baoshang Bank) case, the latest completed bank insolvency case in China, the First Intermediate People's Court of Beijing Municipality mainly applied Article 2 of the *Enterprise Bankruptcy Law 2006* as the grounds for opening the insolvency proceeding of Baoshang Bank, while treated Article 71 of the *Law on Commercial Banks 2015* as a supplementary provision.<sup>88</sup> The court also cited a statutory interpretation of insolvency factors in Article 2 of the *Enterprise Bankruptcy Law 2006* from the Supreme People's Court, in which the court could consider that a company is unable to pay its debts when the audit report or the balance sheet of the company shows that the assets cannot pay its debts.<sup>89</sup> Although the specialized law prevails over the general law according to the general rule of statute hierarchy in China,<sup>90</sup> the court still refers to applying the insolvency test in the general insolvency law in dealing with the latest bank insolvency case, probably because the court also agrees with some critics in academia who think that the insolvency provision in the *Law on Commercial Banks 2015* is too ambiguous to apply.<sup>91</sup>

In comparison with Article 71, Article 2 of the *Enterprise Bankruptcy Law 2006* provides a more accurate criterion for the factual financial condition of a

<sup>84</sup> See Banking Act 2009, §96 (UK).

<sup>85</sup> See Act 2009, Section 96.

<sup>86</sup> See Ross B. Leckow, *The IMF/World Bank Global Insolvency Initiative — Its Purpose and Principal Features*, in BANK RESTRUCTURING AND RESOLUTION 188 (David S. Hoelscher ed., International Monetary Fund 1995).

<sup>87</sup> See Zhang Linseng (张林森), *Jianli Guoyou Shangye Yinhang Pochan Falv Zhidu de Sikao* (建立国有商业银行破产法律制度的思考) [Establishing a State-owned Commercial Bank Insolvency Regime], 11 QIYE JINGJI (企业经济) [ENTER. ECON.] 150, 151 (2002).

<sup>88</sup> See The First Intermediate People's Court of Beijing Municipality, *supra* note 63.

<sup>89</sup> See *id.*; Zuigao Renmin Fayuan Guanyu Shiyong Zhonghua Renmin Gongheguo Qiye Pochan Fa Ruogan Wenti de Guiding Yi (最高人民法院关于适用《中华人民共和国企业破产法》若干问题的规定(一)) [Provisions (I) of the Supreme People's Court on Several Issues concerning the Application of the Enterprise Bankruptcy Law of the People's Republic of China] (promulgated by Sup. People's Ct., Sept. 9, 2011, effective Sept. 26, 2011), art. 3, (Chinalawinfo).

<sup>90</sup> See Lifa Fa (立法法) [Legislation Law] (promulgated by Nat'l People's Cong., Mar. 15, 2000, effective July 1, 2000, amended Mar. 15, 2015), art. 92, (Chinalawinfo).

<sup>91</sup> See Zhang, *supra* note 87, at 151.

troubled institution. However, it raises another essential problem in applying the ordinary corporate insolvency law to dealing with banks. If the banking insolvency proceeding commences only as Article 2 shows, it might be too late to take any rescue action for banks rather than to directly wind them up.<sup>92</sup> Because considering some specific features of banks and particular objectives of banking insolvency, the key purposes of a bank resolution regime are not only to take early and speedy actions by authorities but also to either restore the bank to viability or assist the insolvent bank to exit the market orderly.<sup>93</sup> In contrast with Article 2 of the *Enterprise Bankruptcy Law 2006*, the insolvency test in Article 71 of the *Law on Commercial Banks 2015* seems more loose and flexible than Article 2 of the *Enterprise Bankruptcy Law 2006*, which indeed gives the authorities more leeway to take pre-emptive actions accordingly.<sup>94</sup> Some explain that this regulation shows the determination of the state to maintain financial stability and protect the public interest since this provision provides regulators with considerable discretion and flexible enforcement in dealing with bank insolvency cases.<sup>95</sup> But some immediately point out that such vague and ambiguous rules will make regulators and courts too confused to initiate the banking insolvency procedure.<sup>96</sup>

To conclude, whilst the requirement that banking insolvency should be initiated prior to a bank becoming balance sheet and cash flow insolvent is regarded as essential if such regulations are to be effective, the current regime still has some fundamental ambiguities in action. Hence, many claim that it is time to create new and more targeted legislation.<sup>97</sup> The discussions of solutions will be provided in the fifth part of this article.

### B. Regulatory Standards

According to Article 71 of the *Law on Commercial Banks 2015* and Article 134 of the *Enterprise Bankruptcy Law 2006*, if a commercial bank fails to pay its debts, the China Banking and Insurance Regulatory Commission (CBIRC) may apply to courts for reorganization or liquidation and the court should obtain the permission of CBIRC before issuing the insolvency order.<sup>98</sup> A moratorium can be issued by courts when the bank is under an administrative takeover by regulators, including CBIRC and PBOC.<sup>99</sup> Therefore, in China, “regulatory

<sup>92</sup> See Leckow, *supra* note 86.

<sup>93</sup> See BASEL COMMITTEE ON BANKING SUPERVISION, REPORT AND RECOMMENDATIONS OF THE CROSS-BORDER BANK RESOLUTION GROUP 1 (Bank for International Settlements, September 2009).

<sup>94</sup> See Zhao Wanyi (赵万一) & Wu Min (吴敏), *Woguo Shangye Yinhang Pochan Falv Zhidu Goujian de Fansi* (我国商业银行破产法律制度构建的反思) [*Reconsideration on Chinese Commercial Bank Insolvency Legal System*], 3 XIANDAI FAXUE (现代法学) [MOD. L. SCI.] 83, 86 (2006).

<sup>95</sup> See *id.*

<sup>96</sup> See Kong & Sun, *supra* note 22, at 433.

<sup>97</sup> See KONG, *supra* note 6.

<sup>98</sup> See *Enterprise Bankruptcy Law 2006*, art. 134; *Law of the People's Republic of China on Commercial Bank 2015*, art. 71.

<sup>99</sup> See *id.*

consent” is not only a ground for initiating bank insolvency, but also the core element to trigger the procedure.<sup>100</sup>

However, the existing provisions are too general and ambiguous. They give too much leeway and discretion to CBIRC in handling bank failures, meaning that the commencement of bank insolvencies in China largely depends on the decision of the regulators instead of the insolvency test in laws.<sup>101</sup> The insolvency of Baoshang Bank is a good illustration of this point. The court in fact made a bank insolvency order by following the direction of CBIRC,<sup>102</sup> so the decision of initiating insolvency would not be changed no matter what provisions, such as either Article 2 or Article 71, were applied by the court.<sup>103</sup> It also explains the reason that China could handle bank insolvency even if the statutory grounds for insolvency are not reasonable since the regulator’s administrative power dominates the whole process.<sup>104</sup> One criticism is that the excessive administrative intervention along with an unreasonable legal framework split the commencement process from statutory grounds of bank insolvency.<sup>105</sup> Moreover, if the commencement of bank insolvencies in China cannot be started in accordance with the laws instead of following the direction of authorities, the current legal framework of banking insolvency will never become a real valid regulation, because the direction of authorities is uncertain and not specific.<sup>106</sup> In other words, “regulatory consent” is likely to become an obstacle for Chinese banks to enter the insolvency proceeding, because the standard of “regulatory consent” is not clear, which leads to the scenario of “one case one solution” and the lack of the rule of law.<sup>107</sup>

In fact, the regulators have their own set of standards not only including the standards in *Enterprise Bankruptcy Law* and *Law on Commercial Banks* but also including some non-statutory conventional rules based on the socio-economic situation. For example, many banks are SOEs, in which the process of the reallocation of employees may cost a long time. Whether such

<sup>100</sup> See ZHOU ZHONGFEI (周仲飞), *YINHANG FA YANJIU* (银行法研究) [A STUDY OF THE BANKING LAW] 87 (Shanghai University of Finance and Economics Press 2010).

<sup>101</sup> See Kong, *supra* note 6, at 15.

<sup>102</sup> See Wu Tingting (吴婷婷) & Dai E (戴鄂), *Yinbao Jianhui Tongyi Baoshang Yinhang Pochan Chuhui Quanyi Youbaozhang* (银保监会原则同意包商银行破产 储户权益有保障) [China Banking and Insurance Regulatory Commission Agrees to Baoshang Bank Limited’s Bankruptcy and Depositors Will Be Protected], SINA FINANCE (Nov. 24, 2020), <https://finance.sina.com.cn/money/bank/gsd/2020-11-24/doc-iiznctke3082060.shtml>.

<sup>103</sup> See Guanyü Rending Baoshang Yinhang Fasheng Wufa Shengcun Chufa Shijian de Tongzhi (关于认定包商银行发生无法生存触发事件的通知) [The Confirmation of Baoshang Bank Limited’s Nonviable Situation], SINA FINANCE (Nov. 14, 2020), <https://baijiahao.baidu.com/s?id=1683314643796273056&wfr=spider&for=pc>.

<sup>104</sup> See He, *supra* note 31.

<sup>105</sup> See Liu Weilin (刘伟林), *Cong Guangxin Pochan Kan Woguo Jinrong Jigou Shichang Tuichu* (从广信破产看我国金融机构市场退出) [Lessons from the Insolvency of Financial Institutions: the Case of Guangxin], 8 JINRONG YANJIU (金融研究) [FIN. STUD.] 67, 69 (1999).

<sup>106</sup> See Liu, *supra* note 1, at 59.

<sup>107</sup> See Kong & Sun, *supra* note 22, at 427.

reallocation needs to be completed before the commencement of bank insolvencies is still controversial.<sup>108</sup> In addition, bank insolvencies encounter the same problem as ordinary enterprises, as some local governments may intervene in bankrupt cases improperly, which makes the insolvency process unable to execute smoothly or achieve the objectives of administration or liquidation.<sup>109</sup>

In academia, the common regulatory standard is described as seriously lacking financial soundness and material regulatory breaches, which may lead to insolvency or withdrawal of banks' authorization/licenses.<sup>110</sup> If the regulators find that a bank does not fulfill the regulatory requirements, such as balance sheet and cash flow test or capital adequacy ratio, the regulators may take measures to take over or liquidate the bank.<sup>111</sup> However, this standard is only wildly discussed in academia and slightly mentioned in some "umbrella provisions" in law.<sup>112</sup>

It is worth noting that, some implicit factors, which are not specifically shown in the statute, deeply influence regulators' decisions in China. For example, regulators may consider the bank insolvency case linked to the public interest and social stability.<sup>113</sup> In comparison with the approach in the United Kingdom, the grounds for initiating the insolvency proceeding also link to the public interest, which is a statutory rule.<sup>114</sup> In the United Kingdom, even if a bank does not meet insolvent requirements of 'that a bank is unable, or likely to become unable to pay its debts, the Secretary of State can apply for a bank insolvency order to protect the public interest.<sup>115</sup> However, the British approach is to initiate bank insolvency promptly in view of the public interest, whereas the Chinese approach is causing the opposite effect, which is the so-called Chinese version of the "too-big-to-fail" issue due to the protection of the public interest. For instance, in a few cases, the bank has already faced technical insolvency by accounting standards but to protect its customers, the regulators do not allow the bank to enter the insolvency procedure promptly.<sup>116</sup> In 1999, to improve the balance sheets of commercial banks, to keep a resilient financial

<sup>108</sup> See Wang Dongming (王东明), *Quanguo Renmin Daibiao Dahui Changwu Weiyuanhui Zhifa Jianchazu Guanyu Jiancha Zhonghua Renmin Gongheguo Qiye Pochanfa Shishi Baogao* (全国人民代表大会常务委员会执法检查组关于检查《中华人民共和国企业破产法》实施情况的报告) [*The Law Enforcement Inspection Team of the Standing Committee of the National People's Congress: Report on Examining the Implementation of the Enterprise Bankruptcy Law of the People's Republic of China*], WEB OF NAT'L PEOPLE'S CONG. (Aug. 18, 2021), <http://www.npc.gov.cn/npc/kgfb/202108/0cf4f41b72fe4ddeb3d536dfe3103eb3.shtml>.

<sup>109</sup> See *id.*

<sup>110</sup> See *Supra* note 100, at 387.

<sup>111</sup> See *id.*

<sup>112</sup> See *Yinhangye Jiandu Guanli Fa* (银行业监督管理法) [Banking Supervision Law] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 31, 2006, effective Jan. 1, 2007), art. 38 (Chinalawinfo).

<sup>113</sup> See ZHOU, *supra* note 110, at 388.

<sup>114</sup> See Banking Act 2009, §96 (UK).

<sup>115</sup> See Insolvency Act 1986, §124A (UK).

<sup>116</sup> See Davis, et al., *supra* note 29.

system, and to prevent troubled banks from collapsing, the Chinese Treasury invested RMB10 billion to set up four Asset Management Companies, Cinda, Huarong, Great Wall, and Orient Asset Management Corporation, to look after non-performing loans of Chinese banks, especially the biggest four Chinese banks, which are at the same time the top four banks in the world.<sup>117</sup>

In addition, to maintain social stability, the regulators will formulate different regulatory standards for initiating insolvency procedures for each case according to the social influence brought by the bankruptcy of the troubled bank.<sup>118</sup> Taking Baoshang Bank as an example, the regulators permitted the take-over team to ignore existing legal rules and directly guaranteed the full payment to all individual saving depositors and up to RMB 50 million debts of non-individual debts, whereas the de facto statutory rule is that depositors could receive up to RMB 500,000 compensation during the bank liquidation according to the *Deposit Insurance Regulation*.<sup>119</sup> Eventually, 99.98% of Baoshang Bank's creditors were fully repaid before initiating the formal insolvency procedure.<sup>120</sup> This is the result of the exercise of discretion by the authorities concerned. The regulators explained this by arguing that in order to maintain social stability and the public interest, they cannot approve the bank filing for insolvency without doing so.<sup>121</sup>

Against this backdrop, defining the scope of “regulatory standards” in China becomes a priority. In academia, a large number of discussions draw on the trigger when a troubled bank is supposed to be placed into insolvency, which mainly involves a choice between “a narrowly defined hard threshold” and “a more ambiguous softer one”.<sup>122</sup> Advocates of “a more ambiguous softer threshold” believe that banking insolvency may not occur many times; therefore by retaining the large discretion of regulators, it is possible to make a professional judgment and an appropriate decision considering the use of resolution tools, whereas a hard regulatory threshold cannot well capture the complicated deterioration of financial market.<sup>123</sup> It is also the reason why the current approach is conceivable in China because some politicians believe that the bank insolvency regulation is entirely controlled by the banking supervisory authority; there would be no large-scale bank insolvency cases in the future and

<sup>117</sup> See Zhang et al., *supra* note 20.

<sup>118</sup> See Kong & Sun, *supra* note 22, at 426.

<sup>119</sup> See Wu, *supra* note 55. Cunkuan Baoxian Tiaoli (存款保险条例) [Deposit Insurance Regulation] (promulgated by St. Council, Feb. 17, 2015, effective May 1, 2015), art. 5 (Chinalawinfo).

<sup>120</sup> See *Chinese Regulators Will Restructure Baoshang Bank as Soon as Possible*, REUTERS (June 16, 2019, 7:20 PM), <https://www.reuters.com/article/uk-china-baoshang-restructure/chinese-regulators-will-restructure-baoshang-bank-as-soon-as-possible-idUKKCN1TH0C9>.

<sup>121</sup> See Wu, *supra* note 55.

<sup>122</sup> See Alan Davies, *Bank Resolution in the UK: Creating a Culture of Early Intervention*, 8 Law & Fin.Mkts.Rev. 352, 354 (2014).

<sup>123</sup> See MARTIN Cihak & ERLAND Nier, THE NEED FOR SPECIAL RESOLUTION REGIMES FOR FINANCIAL INSTITUTIONS—THE CASE OF THE EUROPEAN UNION 14 (Int'l. Monetary Fund eds., 2009) <https://www.elibrary.imf.org/view/journals/001/2009/200/001.2009.issue-200-en.xml>.

the bankruptcy of some small banks is totally under the control of the government.<sup>124</sup>

On the contrary, advocates of “a more prescriptive and hard trigger” hold the opinion that giving Chinese regulators large discretion in determining when to intervene may lead to the authorities abusing their powers to provide the state guarantee for banks, especially state-owned banks.<sup>125</sup> But in the United States and the United Kingdom, scholars are more concerned about such sole responsibility for decision commencement which may cause “intervention being delayed past the point at which it is socially optimal”.<sup>126</sup> Hence, a narrowly defined hard threshold was introduced in the United States to limit the scope for forbearance, but the United States still retains substantial discretion to discern the best course of action.<sup>127</sup> The United Kingdom also tries to keep a balance between a clear-cut trigger standard and the discretion of the Prudential Regulation Authority.<sup>128</sup> Dalvinder Singh’s interpretation of the approach in the United Kingdom is that the criteria of the authorities “will not necessarily be beyond reasonable doubts, but will be close enough so that the decision to pull the trigger is made with the appropriate level of confidence”.<sup>129</sup>

Overall, the most significant difference between bank insolvency and enterprise insolvency in China is that banks need the consent of the banking regulators to enter the insolvency proceeding, but the method of constraining the discretion of the authorities during the commencement of bank insolvency is still pending. The current dilemma of the Chinese approach can be summed up in the words of Boot and Thakor, who point out that the regulators’ desire of obtaining a reputation may distort the motivation to intervene in a failing bank and influence the soundness of the banking system.<sup>130</sup> Furthermore, no matter whether to choose a hard threshold or a soft one to develop the current approach, the essence of improving the regulatory standard is supposed to initiate the proceeding quickly and efficiently.<sup>131</sup>

<sup>124</sup> See Wu, *supra* note 55.

<sup>125</sup> See Xing Huiqiang (邢会强), *Woguo Zuihou Daikuanren Falü Zhidu de Wanshan* (我国最后贷款人法律制度的完善) [*To Improve the Mechanism of Last Lender of Resort in China*], (1 NANDU XUETAN (南都学坛) [ACAD. F. OF NANDU] 88, 90 (2005).

<sup>126</sup> See Davies, *supra* note 122.

<sup>127</sup> See *id.*

<sup>128</sup> See THE PRUDENTIAL REGUL. AUTH. OF BANK OF ENGLAND, *THE PRUDENTIAL REGULATION AUTHORITY’S APPROACH TO BANKING SUPERVISION* 6 (The Prudential Regulatory Authority of Bank of England eds., 2018), <https://www.bankofengland.co.uk/prudential-regulation/publication/pras-approach-to-supervision-of-the-banking-and-insurance-sectors>.

<sup>129</sup> See Dalvinder Singh, *The UK Banking Act 2009, Pre-Insolvency and Early Intervention: Policy and Practice* 14 (Warwick Sch. of L., Working Paper No. 2010/27, 2010), <http://wrap.warwick.ac.uk/60622/> (last visited on May 1, 2022).

<sup>130</sup> See Arnoud W.A. Boot & Anjan V. Thakor, *Self-interested Bank Regulation* 83 AM. ECON. REV. 206 (1993).

<sup>131</sup> See Cihark & Nier, *supra* note 123.

#### IV. WHO IS ENTITLED TO INITIATE THE BANK INSOLVENCY PROCEEDING IN CHINA?

According to Article 71 of the *Law on Commercial Banks 2015*, with the consent of banking regulators, the people's court is empowered to declare insolvency.<sup>132</sup> In theory, the insolvency process can be commenced by the banking regulatory authority, creditors, and debtors.<sup>133</sup> It is worth noting that the regulatory authority is not only one of the applicants to file for insolvency but also the supervisory authority that gives permission for the commencement of bank insolvency to the court. Therefore, the regulatory authority becomes the decisive institution standing to file insolvency in China. As a result, the regulatory authority is the *de facto* insolvency initiator, while creditors and debtors are initiators in formality. Hence, this part provides a discussion of the standing for filing insolvency in China by analyzing the current rules.

##### A. The Banking Regulatory Authority

According to the *Enterprise Bankruptcy Law 2006*, if a failed company is a banking institution, except shareholders, creditors, and debtors, CBIRC can also initiate the insolvency proceeding.<sup>134</sup> In addition, the law empowers CBIRC to approve the commencement of banking insolvency.<sup>135</sup> The legislative purpose of this regulation can be illustrated in two points. First, if the failing banks do not file for insolvency in time, it is necessary to authorize CBIRC to initiate the insolvency procedure in order to reduce the systemic risk in the financial system.<sup>136</sup> Meanwhile, the approval of CBIRC could help avoid the loss of public confidence in the financial system as a whole.<sup>137</sup> This idea is emphasized by Mr. Jian An, then deputy director of the legislative affairs commission in the NPC Standing Committee, who even believes that CBIRC should have the exclusive right to file for insolvency in China.<sup>138</sup> Second, banking insolvency involves a large number of creditors related to the soundness of the financial community and social stability, which requires

<sup>132</sup> See *id.*

<sup>133</sup> See Qiye Pochan Fa (企业破产法) [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), art. 2, art. 87 and art. 181 (Chinalawinfo).

<sup>134</sup> See *id.*

<sup>135</sup> See Qiye Pochan Fa (企业破产法) [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), art. 134 (Chinalawinfo). Shangye Yinhang Fa (商业银行法) [Law on Commercial Bank] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 29, 2015, effective Oct. 1, 2015), art. 71 (Chinalawinfo).

<sup>136</sup> See Qian Haomin (钱昊旻), Shentu Qingnan (申屠青南) and Yu Liang (俞靓), *Pochanfa Lifa Beihou de Gushi* (破产法立法背后的故事) [The Story Behind the Bankruptcy Law Legislation], ZHONGGUO ZHENGQUAN BAO (中国证券报) [CHINA SECURITIES JOURNAL], Aug. 28, 2006, at A07.

<sup>137</sup> See *id.*

<sup>138</sup> See *id.*

prudential regulation over the financial system, so CBIRC is designed as the role of a counselor as well as a regulator in the banking system.<sup>139</sup>

In addition, the general company insolvency law cannot cope with bank insolvencies adequately, so the involvement of CBIRC is essential. Arguably, banks have many distinctive characteristics and banks are unique in their business as compared to corporate businesses. For example, banks typically hold leverage and maturity that mismatch the balance sheet, which makes them susceptible to runs and loss of public confidence while a massive bank run will cause liquidity problems that threaten the bank's solvency. Banks provide fundamental services to support the functioning of the economy, such as deposit-taking, credit extension, and processing payments, which cannot be fully replaced by other non-bank financial institutions. Moreover, banks constitute a core element in the delivery of monetary policies and the key intermediation between the monetary policy process and the macroeconomy.<sup>140</sup> Thus, banks need a more prudential regulation framework than normal companies and it explains why it is necessary for the involvement of CBIRC.

In practice, before the bank files a petition with the court for the declaration of insolvency, it is supposed to submit a report to CBIRC for approval. Moreover, creditors also face large difficulties in filing the insolvency application to the court since CBIRC rarely gives permission to creditors.<sup>141</sup> A note of caution is due here that there has not been a single bank insolvency case where the creditor successfully filed a petition for insolvency.<sup>142</sup> Therefore, CBIRC seems to be the sole authority that is able to initiate insolvency proceedings despite what the *Enterprise Bankruptcy Law 2006* states; this is why Kong concludes that neither creditors nor debtors can initiate the banking insolvency proceeding in China.<sup>143</sup>

Another reason for the commencement of bank insolvencies to be initiated by the banking regulator is that it usually assumes the leadership during bank resolution before the bank formally enters the insolvency proceeding; for example, CBIRC or/and PBOC (People's Bank of China) may take over the troubled bank to operate and resolve the business.<sup>144</sup> It is worth noting that the assumption of control by authorities is not a necessity according to the existing rules, but it has indeed become a prerequisite in accordance with previous insolvency cases, such as Hainan Development Bank (in 1998) and Inner

<sup>139</sup> See Qian Haomim (钱昊旻), *Jinrong Jigou Pochan Chengxu Mingque* (金融机构破产程序明确) [Procedures of Financial Institution Insolvency Are Clear Now], ZHONGGUO ZHENGQUAN BAO (中国证券报) [CHINA SECURITIES], Aug. 23, 2006, at A01.

<sup>140</sup> See Eva H.G. Hüpkens, *Insolvency—Why a Special Regime for Banks*, 3 CURRENT DEV. MONETARY & FIN. L. 471, 473 (2002).

<sup>141</sup> See Kong, *supra* note 6, at 49.

<sup>142</sup> See *id.*

<sup>143</sup> See *id.*

<sup>144</sup> See Shangye Yinhang Fa (商业银行法) [Law on Commercial Banks] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 29, 2015, effective Oct. 1, 2015), art. 64 (Chinalawinfo). Yinhangye Jiandu Guanli Fa (银行业监督管理法) [Banking Supervision Law] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 31, 2006, effective Jan. 1, 2007), art.38 (Chinalawinfo).



Mongolia-Based Baoshang Bank (in 2019).<sup>145</sup> In addition, unlike the United Kingdom, Chinese law does not empower the central bank or the Treasury to initiate banking insolvency; instead, its structure is similar to the American approach, where only the chartering agency or the federal regulatory agency can stand to file for insolvency.<sup>146</sup> Therefore, the reasonable conclusion is that CBIRC is the exclusive administrative authority that can initiate the bank insolvency procedure in China.

However, what makes the commencement of bank insolvencies more complex is the ultimate control by Central Financial and Economic Commission, which is known as the Panel for Financial and Economic Affairs in the previous time. It is an internal sub-committee of the China Communist Party (CCP) Central Committee, which is the real policy marker of financial and economic affairs in China. The leaders of this commission consist of the president and the prime minister of China, so this body has the power to lead and supervise all economic works of the State Council. Hence, the commission always acts a key leading role and represents the attitude of the central government in dealing with financial issues in most cases, such as whether to permit the insolvency of an individual bank.<sup>147</sup> The relationship among the CCP Central Financial and Economic Commission, the State Council, PBOC, and CBIRC can be shown as follows. CCP Central Financial and Economic Commission makes guidance on PBOC, and CBIRC, which are the departments or the public institutions of the State Council. CCP Central Financial and Economic Commission checks the working report from PBOC and CBIRC, whereas PBOC and CBIRC follow the macroscopic guidance of the decision made by CCP Central Financial and Economic Commission and put this guidance into practice.<sup>148</sup>

Furthermore, most of the banks in China are state-controlled and are protected by the state to some degree, so the regulatory authorities would be very prudential when deciding the commencement of banking insolvency.<sup>149</sup> This is also a key reason why it is so difficult for banks to enter insolvency proceedings in China. Based on existing experiences, if a bank is able to go bankrupt, either it is abandoned by the state or it is a private or less state-linked bank.<sup>150</sup> For example, in 2019, the Inner Mongolia-Based Baoshang Bank and the Bank of Jinzhou both faced liquidity troubles. The Bank of Jinzhou (a state-owned joint-stock bank) is rescued by capital injections from state-owned entities, whereas the Baoshang Bank (a private bank) was finally liquidated and

<sup>145</sup> See *Supra* note 62.

<sup>146</sup> See *Supra* note 8, at 26.

<sup>147</sup> See Kong, *supra* note 6, at 43.

<sup>148</sup> See *Xij Jinping Zhuchi Zhaokai Zhongyang Caijing Weiyuanhui Dishi Yici Huiyi* (习近平主持召开中央财经委员会第十一次会议) [Xi Jinping Presided over the Eleventh Meeting of the Central Finance and Economics Committee], XINHUA NET (Apr. 26, 2022), [http://www.gov.cn/xinwen/2022-04/26/content\\_5687372.htm](http://www.gov.cn/xinwen/2022-04/26/content_5687372.htm).

<sup>149</sup> See Wu, *supra* note 55.

<sup>150</sup> See Xing, *supra* note 125, at 90.

the director of the bank was jailed.<sup>151</sup> It can be presumed that the regulatory authorities are more likely to save state-owned or state-linked banks rather than private ones.

Given that administrative power decides the commencement of bank insolvencies in China, it raises a problem of whether the court can make a thorough and substantive judicial review of the commencement under the approval of CBIRC. Considering the law in books, courts could decide whether to accept an insolvency petition or not.<sup>152</sup> However, regarding the law in action, the preferred choice for courts in China is to follow the administrative arrangement, which means that the commencement of a judicial procedure for banking insolvency in China becomes part of the regulatory tools of the state to solve unwanted insolvent banks, whereas some banks that truly meet the criteria for insolvency may not be able to enter the judicial insolvency proceeding.<sup>153</sup> This point of view is also confirmed by Zhang who argues that this is one of the unique features of financial institutions' insolvency in China.<sup>154</sup>

### B. Other Stakeholders' Voices

Generally speaking, the authorities collect information from the bank, its depositors, and other creditors first to start an initial investigation of the troubled bank and then allow the bank to enter a court-based insolvency procedure to determine the validity of claims, dispose of the assets, and pay off the liabilities.<sup>155</sup> In theory, the applicants for bank insolvencies are supposed to be similar to the general company insolvency, including creditors, debtors, and major shareholders. The only difference is that the banking regulators can also file for insolvency.<sup>156</sup> However, as Wang and Chen argue, ordinary creditors are not suitable for initiating bankruptcy since the number of creditors is too large.<sup>157</sup> In practice, the troubled bank will not file insolvency directly to the court, skipping the step of applying to the banking regulators. Chinese banking insolvency is a court-based regime in theory but is routinely controlled by administrative authorities in effect.<sup>158</sup> During the commencement period, the

<sup>151</sup> See Li Yumin (李玉敏), *Bei Jieguan Haishi Chongzu, Baoshang he Jinzhou Yinhang Weihe Jiejü Jiongyi?* (被接管还是重组, 包商和锦州银行为何结局迥异?) [*Being Taken-over or Reorganized, why did Baoshang and Jinzhou Bank End up So Different?*], 21ST CENTURY BUSINESS HERALD (Aug. 8, 2019), <https://www.jiemian.com/article/3387067.html>.

<sup>152</sup> See *Qiye Pochan Fa* (企业破产法) [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), art. 10 (Chinalawinfo).

<sup>153</sup> See He, *supra* note 31, at 872.

<sup>154</sup> See Zhang Zinian, *Bankruptcy of Financial Institutions: Lessons of Securities Company Insolvencies from China*, 2 Corp. & Bus. L.J. 302, 327 (2021).

<sup>155</sup> See *Shangye Yinhang Fa* (商业银行法) [Law on Commercial Bank] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 29, 2015, effective Oct. 1, 2015), art. 71 (Chinalawinfo).

<sup>156</sup> See Wang and Chen, *supra* note 3, at 22.

<sup>157</sup> See *id.*, at 24.

<sup>158</sup> See *Shangye Yinhang Fa* (商业银行法) [Law on Commercial Bank] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 29, 2015, effective Oct. 1, 2015), art. 64 (Chinalawinfo). *Qiye Pochan Fa*

essential role of the court *de facto* is to issue an insolvency order with the consent of the regulators.<sup>159</sup> Arguably, the regulator's administrative power seems to dominate the commencement process, while other stakeholders' voices, especially creditors, are not well taken into account to some extent.

According to Article 7 of the *Enterprise Bankruptcy Law 2006*, the law permits creditors to stand for insolvencies, such as administration and liquidation procedures.<sup>160</sup> However, executing this provision is not easy. Creditors' voices have not been heard much during the commencement of bank insolvencies in practice.<sup>161</sup> For instance, there is no mechanism for creditors to participate in the decision-making process of the commencement in China. According to the existing ambiguous rules, creditors have no standing rights to appeal decisions of commencement and debt distributions until the commencement of judicial insolvency procedure, but it seems too late to get involved after the commencement of bank insolvencies under current circumstances.

In addition, when a bank is unable to pay its debts but is also not entering the insolvency proceeding, depositors have no other choice but to report their difficulties to CBIRC or local governments.<sup>162</sup> The court will not accept the case immediately when creditors file for bank insolvency; instead, the court will ask for advice from the upper hierarchy court and discuss the situation with banking regulators. This probably explains the reason why angry depositors protested at the front gate of the Henan CBIRC office instead of going to the court when they could not withdraw cash from banks.<sup>163</sup> In 2022, creditors of five small-town banks faced such a dilemma and the issue has not been solved by CBIRC yet.<sup>164</sup> The legal consequence would be that the local banking regulatory authority will use administrative rather than judicial force to rescue or restructure the troubled bank if the situation is not critical.<sup>165</sup> But creditors, both depositors and investors, may not be paid during this period.<sup>166</sup> In these five cases, depositors have been struggling for over two months to retrieve

(企业破产法) [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), art 134 (Chinalawinfo).

<sup>159</sup> See *Shangye Yinhang Fa* (商业银行法) [Law on Commercial Bank] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 29, 2015, effective Oct. 1, 2015), art 71 (Chinalawinfo).

<sup>160</sup> See *Qiyue Pochan Fa* (企业破产法) [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), art. 7 (Chinalawinfo).

<sup>161</sup> See Kong, *supra* note 6, at 49.

<sup>162</sup> See *Dafu Guanyu Gongbu Hainan Fazhan Yinhang Qingsuan Qingkuang de Jianyi* (答复关于公布海南发展银行清算情况的建议) [Response to the Advice on Hainan Development Bank's Liquidation], THE PEOPLE'S GOV'T OF HAINAN PROVINCE (Sept. 3, 2012), <https://www.hainan.gov.cn/zxtadata-5053.html>.

<sup>163</sup> See Cheng Leng, *Runs on Chinese Local Banks Spur Fears over Health of Regional Lenders*, FIN. TIMES (June 9, 2022), <https://www.ft.com/content/fc0ba3e7-605f-46c3-b388-6bc44968cdda>.

<sup>164</sup> The names of five banks are: Yüzhou Xinminsheng Town Bank, Henan Shangcai Huimin Town Bank, Tacheng Huanghuai Town Bank, Kaifeng Xindongfang Town Bank, and Anhui Guzhen Xinhuaihe Town Bank.

<sup>165</sup> See *Shangye Yinhang Fa* (商业银行法) [Law on Commercial Bank] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 29, 2015, effective Oct. 1, 2015), art. 64 (Chinalawinfo).

<sup>166</sup> See *supra* note 66.

frozen deposits, but they still cannot initiate the banking insolvency proceeding to the court.<sup>167</sup> It is worth mentioning that the Chinese Deposit Insurance Corporation (CDIC), a representative of depositors, did not take any legal actions to help depositors during these cases.

Generally speaking, CDIC is supposed to pay a limited amount of compensation before entering the liquidation procedure in accordance with the law.<sup>168</sup> The depositors who are not covered by CDIC will bear the brunt of the loss and get the recovery from the remaining assets during liquidation.<sup>169</sup> However, in fact, CDIC always pays off excess liabilities due to the government's commitment for the sake of calming the depositors.<sup>170</sup> It has no choice but to follow the direction of the central government. In the Baoshang case, it directly guaranteed full payment to all individual saving depositors and up to RMB 50 million debts of non-individual debts.<sup>171</sup> Its high compensation derives from the deposit insurance funds, but ultimately, the whole financial system paid the bill for Baoshang Bank.<sup>172</sup> A similar situation occurred when Hainan Development Bank faced an insolvency issue. Hainan Development Bank was controlled by the local government in 1998.<sup>173</sup> Under the policy at that time, when Hainan Development Bank was unable to pay its debts, Hainan local government should pay debts instead.<sup>174</sup> However, the local government could not afford to pay all of the bank's liabilities, and for the purpose of maintaining social stability, the government decided to only pay individual depositors while shunning the rest of the creditors including business depositors.<sup>175</sup>

As a result, such a Chinese-characteristic solution may violate some creditors' rights. For example, in some cases, such as Hainan Development Bank and Hebei Suning Shangcun Credit Cooperative, the takeover team disposed of the assets and paid off some liabilities without following the capped amount of the current deposit guarantee scheme. Under this circumstance, it is difficult for the other unpaid creditors to be paid during the liquidation procedure. Against this backdrop, these creditors cannot be fairly paid during

<sup>167</sup> See *id.*

<sup>168</sup> See Cunkuan Baoxian Tiaoli (存款保险条例) [Deposit Insurance Regulation] (promulgated by St. Council, Feb. 17, 2015, effective May 1, 2015), art 5 (Chinalawinfo).

<sup>169</sup> See *id.*

<sup>170</sup> See Zhongguo Yinbao Jianhui ZhaoKai Xinwen Fabuhui Jieshao Jinqi Jianguan Zhongdian Gongzuo Kaizhan Qingkuang (中国银保监会召开新闻发布会 介绍近期监管重点工作开展情况) [China Banking and Insurance Regulatory Commission Held a Press Conference to Introduce the Recent Development of Key Regulatory Tasks], WEB OF THE ST. COUNCIL (June 1, 2021), [http://www.gov.cn/xinwen/2021-06/04/content\\_5615416.htm](http://www.gov.cn/xinwen/2021-06/04/content_5615416.htm).

<sup>171</sup> See Wu, *supra* note 55.

<sup>172</sup> See Yang Fen (阳芬), 2021nian Zhongguo Cunkuan Baoxian Jijin Zhuyao Shouru Zhuyao Zhichu Ji Fazhan Qishi Fenxi (2021年中国存款保险基金主要收入、主要支出及发展趋势分析) [Analysis of Main Income, Main Expenditure and Development Trend of China Deposit Insurance Fund in 2021], WEB OF INDUS. INFO. (May 12, 2022), <https://www.chyxx.com/industry/1108358.html>.

<sup>173</sup> See *supra* note 62.

<sup>174</sup> See Kong & Sun, *supra* note 22, at 427.

<sup>175</sup> See *id.*

the liquidation proceeding compared with the others, which is a violation of the basic principle of “no creditor worse off” and causes some creditors to suffer greater losses than they should have. Taking the Baoshang bank as an example again, the method of paying off the liabilities caused no property could be executed by the time of the formal insolvency proceeding initiating, so the liquidation procedure was terminated after the first creditors’ meeting. The legal consequence was that creditors who had not been paid in advance bore the losses of the bank’s failure.<sup>176</sup> The insolvency of Hebei Suning Shangcun Credit Cooperative also illustrates this point.<sup>177</sup>

Nevertheless, from the view of the state, the current mechanism seems to be reasonable and appropriate. Some believe that announcing the bank’s deteriorating condition and initiating the insolvency proceeding early will cause more loss, because the announcement of bank insolvency may decrease the value of the bank as a going concern, thereby it may increase the eventual loss of shareholders and capital note holders of the troubled bank.<sup>178</sup> Therefore, it is necessary to take appropriate action to keep the balance among all stakeholders. It could be possible and reasonable to stipulate that the mere applicant standing for insolvency is the regulator, but it also should be able to set up a scheme to absorb other stakeholders’ voices.

#### V. TWO PROBLEMS OF INITIATING THE BANK INSOLVENCY PROCEEDING IN CHINA

The development of the current banking insolvency regime in China is at a very early stage and it is rare to see bank insolvency cases since the commencement of bank insolvencies in the country faces many difficulties. First, there is a legacy problem in banking insolvency. From the perspective of the historical development of the banking system, banks have a strong link with the government, so it is inconceivable for both of public and officials to believe that banks are supposed to go bankrupt.<sup>179</sup> Second, one of the reasons for inefficient commencement is the structure issue between courts and administrative powers. If their powers and responsibilities are not specific and they cannot coordinate well, the insolvency proceeding will be very difficult to initiate. In a nutshell, the decision of the commencement of bank insolvencies should be cautious and prudential, but the commencement process must be efficient and dynamic. Hence, this part points out two key problems of the commencement of bank insolvencies in China in order to find a reform path to the future regime.

<sup>176</sup> See *supra* note 65.

<sup>177</sup> See Han Tao (韩韬), *Shinian Pochan Lu* (十年破产路) [Ten Years of Insolvency], 11 JINRONG SHIJIE (金融世界) [FIN. WORLD] 76, 76 (2012).

<sup>178</sup> See Edward Brainsilver, *Failing Banks: FDIC’s Options and Constraints*, 21 Admin. L. Rev. 327, 340, (1975).

<sup>179</sup> See Wu, *supra* note 55.

### A. *A Legacy Problem: Inefficient Commencement*

The first point of the inefficient commencement results from the fact that the general insolvency procedure is not suitable to solve bank insolvencies; Bank insolvencies in China largely rely on ordinary corporate insolvency law, although there are some modified provisions for banks.<sup>180</sup> The criteria for entering corporate insolvency in China are based on the balance sheet and cash flow tests.<sup>181</sup> Critics argue that the law cannot take prompt intervention before an extreme deterioration of a troubled bank's value and it does not provide an efficient mechanism to facilitate transfers of deposits as well as the bank's business.<sup>182</sup> As a result, some administrative rules are set up to deal with such circumstances. For example, the commencement should obtain permission from the regulators, because the bank requires state intervention to support deposit transfers and to carry out resolution tools.<sup>183</sup> But the specific regulatory standard and resolution tools are still ambiguous in the existing laws.

Under this circumstance, regulators are reluctant to approve insolvency applications unless they have to. For example, if there is serious mismanagement in the bank, which leads to a serious liquidity problem, and the mismanagement may constitute a crime, such as corruption and embezzling funds, regulators may consider allowing the troubled bank to enter the insolvency procedure, because the cost of rescue is unaffordable for the authorities. For example, since Baoshang Bank was taken over by the regulator, the evidence of corruption and bribery of two former directors of this bank was disclosed to the public at the same time. According to newspapers, many insolvent banks were reported for mismanagement and fraudulent behaviors as well.<sup>184</sup> In some cases, the local large enterprises, local government, and local banks had an inextricable connection; for example, they took advantage of each other; in other words, the local enterprise or the government can easily get loans

<sup>180</sup> See Jihong Zhang, *A Comparative Analysis of Application of Bank Insolvency*, 33 *Ariz. J. Int'l & Compar. L.* 301, 312 (2016).

<sup>181</sup> See Qiye Pochan Fa (企业破产法) [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), art. 2 (Chinalawinfo).

<sup>182</sup> See Bank for Int'l Settlements, *Fernando Restoy, Rastko Vrbaski & Ruth Walters: Bank Failure Management in the European Banking Union: What's Wrong and How to Fix It*, FSI Occasional Papers, No 15, 8 (July 9, 2020), <https://www.bis.org/fsi/fsipapers15.htm>.

<sup>183</sup> See Zhao Shuwen (赵树文) & Hao Dandan (郝丹丹), *You Xingzheng Zhudao Zouxian Fazhi Zhudao de Zhengfu Jiushi Moshi Yanjiu—Yi Meiguo, Zhongguo Xianggang Tequ Zhengfu Jiushi Fazhihua Jingyan wei Jiejian* (由行政主导走向法治主导的政府救市模式研究——以美国、中国香港特区政府救市法治化经验为借鉴) [A Study on the Mode of Government Rescue from Leading to the Rule of Law—the Experience from the United States and Hong Kong Special Administrative Region], 4 *HEBEI JINGMAO DAXUE XUEBAO* (河北经贸大学学报) [J. HEBEI U. ECON. & BUS.] 100, 106 (2018).

<sup>184</sup> See Zhongjiwei Pandian 2020nian Jinrong Lingyu Fanfu Anli :Duoming Yinhang Hangzhang Luoma, Jinding Xindai Shenpi Fubai Wenti (中纪委盘点2020年金融领域反腐案例：多名银行行长落马，紧盯信贷审批腐败问题) [The Summary of Corruption Cases in the Financial Sector in 2020: Several Bank Presidents Have Been Ousted, and More Attention Should be Paid to Address Corruption in Credit Approvals], NAT'L BUS. DAILY (Jan. 2, 2021), <https://baijiahao.baidu.com/s?id=1687764664954803353&wfr=spider&for=pc>.

from local banks while the directors may get some bribes when they decide to approve large amount loans.<sup>185</sup> Such serious mismanagement issues also cause banks to generate huge non-performing loans. When the government cannot afford rescue expenses, it might allow the bank to enter the insolvency process.

In addition, given that the Chinese bank system has some unique features, the commencement of bank insolvencies in China faces more obstacles than in other countries. Initially, banks in China were regarded as government agencies because of the socialist planned economy.<sup>186</sup> Hence, bank insolvency rules seemed to be unnecessary during this period.<sup>187</sup> With a shift from strict socialism to a new market-socialism model, banks in China are gradually commercialized as individual institutions. The time is right to set up insolvency rules. However, the connection between banks and the state is still strong due to the historical legacy, which leads to a situation where the survival of banks has always been guaranteed by the government and it is rare to see bank insolvencies. This is probably why Chinese banking insolvency rules have lagged behind western jurisdictions so far.<sup>188</sup> Therefore, the notion that the ideology of socialism does matter, so the legacy problem becomes a material obstacle in initiating the bank insolvency, as Hsiao points out that “the socialist legacy of state-owned enterprises inclusive of banks, may conflict with bank resolution regime”.<sup>189</sup> However, some might argue that, in most countries, the connection of banks with the state is strong since banking insolvency is too essential to be regulated beyond the court only. For example, the American approach is a pure administrative regime. But the administrative approach does not mean that banking regulatory authority is able to provide implicit guarantees to state-owned banks. The purpose of this approach is to solve banking insolvency issues properly and quickly. On the contrary, the Chinese administrative approach delayed insolvency initiation.

The next point of the inefficient commencement results from the fact that the administrative way for banking insolvency is not aligned with the judicial insolvency framework. Due to the ambiguities of current rules, the implementation is already beyond the law stipulated in the *Enterprise Bankruptcy Law*. This inconsistency leads to some reluctance of the authorities to initiate the insolvency proceeding because both regulators and judges lack a concrete legal basis to apply.<sup>190</sup> The ambiguities could be summarized as

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<sup>185</sup> See Meng Fanxia (孟凡霞) & Song Yitong (宋亦桐), *Jinrong Fanfu Yanxü: Gaoguan Pin Luoma Difang Yinhang Cheng Fubai Duofadi* (金融反腐延续：高管频落马 地方银行成腐败高发地) [*The Continuance of the Anti-corruption Campaign: Senior Executives are Widely Ousted and Local Banks Are Endemic to Corruption*], PEOPLE'S DAILY ONLINE (June 11, 2020), <http://finance.people.com.cn/n1/2020/0611/c1004-31742475.html>.

<sup>186</sup> See Hsiao, *supra* note 19.

<sup>187</sup> See Lu and Zhou, *supra* note 24.

<sup>188</sup> See Rebecca Parry & Yingxiang Long, *China's Enterprise Bankruptcy Law, Building an Infrastructure towards a Market-based Approach*, 20 J. Corp. L. Stud. 157, 157 (2020).

<sup>189</sup> See MARK W. H. HSIAO: REGULATORY PRINCIPLES OF BANKING LAW IN CHINA 193 (2015).

<sup>190</sup> See Kong & Sun, *supra* note 22, at 427.

follows. First, the current approach lacks legal endorsement, which requires amending laws to make rules clear.<sup>191</sup> There are some conflicts between administrative decisions and existing legal provisions, such as disposing of the assets and paying off the liabilities before the commencement of judicial banking liquidation.<sup>192</sup> Second, the rules in existing laws are inconsistent. For example, the grounds for entering banking insolvency stipulated in Article 71 of the *Law on Commercial Banks* and Article 2 of the *Enterprise Bankruptcy Law* are not consistent.<sup>193</sup>

Furthermore, if the current mechanism is based on the *Enterprise Bankruptcy Law*, another question is raised. The issue is whether proceedings, such as reconciliation, reorganization, and liquidation mentioned in the *Enterprise Bankruptcy Law*, are all applicable to banks or not. This issue has not been answered by the official yet.<sup>194</sup> Until now, only a small number of securities companies have entered the reorganization procedure after being approved by regulators, which could provide some lessons for banks. The reconciliation procedure has never been used in any financial institution's insolvency case so far. Although many scholars call for the use of bankruptcy reconciliation in bank insolvencies, which means some creditors will bear some of the burdens by having a portion of their debt written off; policymakers haven't taken any concrete action yet.<sup>195</sup>

The last point of the legacy problem is that authorities are too cautious to dissolve insolvent banks since they connect all bank insolvency cases to the public interest. But the fact is that the failures of many small banks may not meet the public interest threshold.<sup>196</sup> Hence, these banks are supposed to obtain commencement permission from the authorities easier than others. In addition, not all banks need to be bailed out; the use of public funds in small banks is supposed to be more cautious. As Financial Stability Institute points out that "it is anomalous if public support is in principle more easily available in insolvency",<sup>197</sup> because it may distort incentives for banks and regulatory authorities to address bank failures.

<sup>191</sup> See Zhang, *supra* note 180.

<sup>192</sup> See Wu, *supra* note 55.

<sup>193</sup> See Shangye Yinhang Fa (商业银行法) [Law on Commercial Bank] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 29, 2015, effective Oct. 1, 2015), art. 71 (Chinalawinfo). Qiye Pochan Fa (企业破产法) [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), art. 2 (Chinalawinfo).

<sup>194</sup> See Qiye Pochan Fa (企业破产法) [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), Chapter 8, Chapter 9 and Chapter 10 (Chinalawinfo).

<sup>195</sup> See Zhang, *supra* note 180, at 305.

<sup>196</sup> See Du Chuan (杜川), *Quanguo Renda Daibiao Guo Xinming: Xiugai Qiye Pochan Fa, Wanshan Jinrong Jigou Pochan Anpai* (全国人大代表郭新明：修订《企业破产法》，完善金融机构破产安排) [Guo Xinming, a NPC Deputy Said That We Will Revise the Enterprise Bankruptcy Law and Improve Bankruptcy Arrangements for Financial Institutions], YICAI GLOB. (Mar. 9, 2021), <https://www.yicai.com/news/100973159.html>.

<sup>197</sup> See Restoy, Vrbaski & Walters, *supra* note 122, at 13.



*B. A Structural Problem: Coordination Among Various Authorities During Commencement*

When a bank enters an insolvency proceeding, it must obtain the consent of the regulator whereas such regulatory permission is not required for normal enterprises.<sup>198</sup> After entering the insolvency procedure, the banking regulator would continue to participate in the process as a member of the liquidation group, which raises an issue about the connection and coordination between the administrative power of the banking regulator and the judicial power of the court.<sup>199</sup>

The current court-based banking insolvency mechanism is not as functional as it was expected. In theory, courts have discretion in dealing with all matters during the insolvency process, but in reality, this power is taken by regulators. The recent cases illustrate that regulators even have the discretion to determine how and when to pay off debts. Against this backdrop, the power of courts is weakened. Thus, the real purpose of court-based liquidation becomes merely declaring bankruptcy and eliminating remaining debts. Therefore, the structure of Chinese banking insolvency has its unique feature. In fact, all material issues would be solved by regulators, and then, the court declares bankruptcy to deal with some procedural and extraneous issues.

One reason is that most banks are state-linked banks, such as state-owned and joint-stock banks. The local governments are shareholders in many joint-stock banks.<sup>200</sup> Such shareholding structure affects the commencement of bank insolvencies since the state or local governments will endorse the credit of these banks, so the common way to solve failing banks is to use the administrative power to rescue them or suspend the initiation of the insolvency procedure.<sup>201</sup> Hence, updating the court-based approach or switching the current approach to the entire administrative approach becomes a priority in the development of the bank insolvency regime.

Some criticize the current approach, in which the regulator's administrative power dominates the whole process and it seriously affects a failing bank entering the insolvency procedure.<sup>202</sup> Some state that the current approach may

<sup>198</sup> See Shangye Yinhang Fa (商业银行法) [Law on Commercial Bank] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 29, 2015, effective Oct. 1, 2015), art. 71 (Chinalawinfo). Qiye Pochan Fa (企业破产法) [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), art. 2 (Chinalawinfo).

<sup>199</sup> See Huang Tao (黄韬), *Woguo Jinrong Jigou Shichang Tuichu Falü Jizhi Zhongde Quanli Bantu Sifaquan yu Xingzhengquan Guanxi de Shijiao* (我国金融机构市场退出法律机制中的“权力版图” 司法权与行政权关系的视角) [*The Map of Power in Financial Institution Insolvency in China: From the Perspective of the Relationship Between Judicial and Administrative Power*], 21 ZHONGWAI FAXUE (中外法学) [PEKING U.L.J.] 867, 872 (2009).

<sup>200</sup> See Catherine R. Schenk & Emmanuel Mourlon-Druol, *Bank Regulation and Supervision*, in THE OXFORD HANDBOOK OF BANKING AND FINANCIAL HISTORY 412, 422 (Youssef Cassis, Richard S. Grossman & Catherine R. Schenk eds., 2016).

<sup>201</sup> See Li, *supra* note 53, at 19.

<sup>202</sup> See *id.*

trigger the bank insolvency mechanism being used for government purposes.<sup>203</sup> For politicians, maintaining social stability is more important than addressing the distressed banks in a lawful and sustainable way, so there probably will be a continued implicit guarantee to banks by the state, especially state-owned banks, which may increase the moral hazard in the banking sector.<sup>204</sup> Thus, some scholars want to change the current solution for bank insolvency from the current administrative way to a court-centered approach.<sup>205</sup> They believe that the insolvency process, including the administration and winding up process, should be led by courts.<sup>206</sup> The court-based approach could be designed as follows. When a bank meets the criteria for insolvency, the regulators could file for insolvency in court. After the court issues the administration/reorganization or liquidation order, the regulators may nominate an insolvency practitioner to deal with the property of banks and depositors.

This has been seen in the example of the British approach. After the regulators apply for an insolvency order, the bank administrator or liquidator, an officer of the court, is required to complete the priority objective first, such as transferring assets to another purchaser or paying off depositors via Financial Services Compensation Scheme, before the bank enters the normal insolvency procedure.<sup>207</sup> However, the law delegates a large power to the Bank of England, which means the administrative power still plays a fundamental role during banking insolvency.<sup>208</sup> For example, during the completion of the first objective, almost every procedure can only be made with the Bank of England's consent.<sup>209</sup>

Others who support the administrative approach suggest restricting the administrative power, and they believe that China has already formed an elementary administrative model so the involvement of courts is not a necessity, as is the case with the American approach.<sup>210</sup> In recent years, the Chinese government has begun to accelerate the reform of the bank insolvency regime in order to explore various options and methods, which also aims to provide a sustainable and long-term solution to fill existing legal gaps.<sup>211</sup> In 2019, the Chinese central bank established the CDIC, which is designed for

<sup>203</sup> See He, *supra* note 31.

<sup>204</sup> See Kong & Sun, *supra* note 22, at 433.

<sup>205</sup> See He, *supra* note 31.

<sup>206</sup> See *id.*

<sup>207</sup> See DALVINDER SINGH ET AL., *DEBT RESTRUCTURING* 471 (2nd ed. 2016).

<sup>208</sup> See *id.*

<sup>209</sup> See *id.*

<sup>210</sup> See Kong, *supra* note 6.

<sup>211</sup> See Jinrongwei Bangongshi Fabu Shiyi Tiao Jinrong Gaige Cuoshi (金融委办公室发布11条金融改革措施) [*The Financial Stability and Development Committee under the State Council Announced Eleven Measures to Accelerate the Financial Reform*], THE CENT. BANK OF THE PEOPLE'S REPUBLIC OF CHINA (May 27, 2020), <http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/4029293/index.html>.

receivership functions similar to FDIC in the United States.<sup>212</sup> Moreover, according to the *Reform Plan for Accelerating Improvement of the Exit System for Market Participants* issued by the National Development and Reform Commission in 2019, the Chinese central government is exploring the establishment of an insolvency mechanism for financial institutions; one of the main objectives is to clarify the responsibility between banking supervision institutions and courts, and the roles of troubled banks, creditors and administrators or liquidators.<sup>213</sup> In 2020, the new bill of the *Law on Commercial Banks* was published to solicit public comments, in which there is a new chapter proposed for bank insolvency proceedings.<sup>214</sup>

Furthermore, the regulatory authority has begun to invite public opinions on the *Interim Measures for the Implementation of Recovery and Resolution Plans of Banking and Insurance institutions* (hereinafter *Recovery and Resolution Plan*) in 2021 so as to establish a recovery and resolution plan for banks, which is an entirely administrative approach.<sup>215</sup> The body that initiates the bank resolution is CBIRC and its agencies, which is stated in Article 18.<sup>216</sup> In addition, according to Article 2, one of the objectives of the *Recovery and Resolution Plan* is setting up the bail-in tool and other self-rescue finance measures to solve problems rather than obtaining bail-out funds from the state.<sup>217</sup> If this *Recovery and Resolution Plan* enforce, it will be a landmark regulation, so that the state will no longer provide invisible or implicit guarantees for the survival of commercial banks. However, the transition procedure from administrative resolution to a court-based insolvency procedure is not mentioned in this regulation. Hence, the reform of the commencement of bank insolvencies in China is still in the process of discussion and no specific and modified solution has been set up so far.

As a result, the current approach to dealing with banking insolvency has a structural problem, which shows that the government has not yet decided on an appropriate model. Regarding this, some conclude that a jurisdiction that pays

<sup>212</sup> See Shangye Yinhang Fa Xiugai Yijian Gao (商业银行法修改建议稿) [The Proposal to Revise the Law on Commercial Banks/Law on Commercial Banks] (proposed by the People's Bank of China, Oct. 16, 2020, deadline for comments Nov. 16, 2020), art. 92 and art. 100 (Chinalawinfo).

<sup>213</sup> See Guanyu Yinfa Jiakuan Wanshan Shichang Zhuti Tuichu Zhidu Gaige Fangan (关于印发《加快完善市场主体退出制度改革方案》的通知) [Notice on the distribution of the Reform Plan for Accelerating the Improvement of the Exit System for Market Entities], THE ST. COUNCIL (June 22, 2019), [http://www.gov.cn/zhengce/zhengceku/2019-07/16/content\\_5458016.htm](http://www.gov.cn/zhengce/zhengceku/2019-07/16/content_5458016.htm).

<sup>214</sup> See Shangye Yinhang Fa Xiugai Yijian Gao (商业银行法修改建议稿) [The Proposal to Revise the Law on Law on Commercial Banks] (proposed by the People's Bank of China, Oct. 16, 2020, deadline for comments Nov. 16, 2020), Chapter 9 (Chinalawinfo).

<sup>215</sup> See Zhongguo Yinbao Jianhui Jiu Yinhang Baoxian Jigou Huihu he Chuzhi Jihua Shishi Zanxing Banfa (Zhengqiu Yijian Gao) (中国银保监会就《银行保险机构恢复和处置计划实施暂行办法（征求意见稿）》公开征求意见的公告) [China Banking and Insurance Regulatory Commission Announced Interim Measures for the Implementation of Recovery and Resolution Plans of Banking and Insurance institutions], CHINA BANKING AND INS. REGUL. COMM'N, (Feb. 26, 2021), <https://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=968428&itemId=951&generalType=2>.

<sup>216</sup> See *id.*, Art.18.

<sup>217</sup> See *id.*, Art.2.

more attention to controlling the systemic risk will set up an administrative regime to deal with banking insolvency, whereas the court-based regime is more beneficial to the interests of creditors.<sup>218</sup> No matter what the future regime is, the main objective is to set up an efficient banking insolvency mechanism.

#### VI. SOLUTIONS AND POLICY RECOMMENDATIONS: THE ENTRY APPROACH TO BANK INSOLVENCIES

To solve the issues mentioned in the last part, it is necessary to vary the general insolvency rules to adopt the bank insolvency case, especially on the part of grounds of bank insolvency. Moreover, to deal with the structural problem, a consistent bank resolution model should be set up, from the pre-insolvency rescue process to the insolvency proceeding. It is reasonable to allow banking regulators to play a central role in the process of bank insolvency, but it is also reasonable to tie the regulators' powers in the meantime.

Regarding the above arguments, this part provides some policy recommendations for future banking law reform, especially in the field of the commencement of bank insolvencies. The solutions are mainly based on the framework mentioned by the Financial Stability Board (FSB), which published "Key Attributes for Effective Resolution Regimes for Financial Institutions" (hereinafter Key Attributes) in 2011. The Key Attributes were formulated partly based on some existing measures adopted by the experienced countries, such as the United Kingdom under the Banking Act 2009 and the United States under the Dodd-Frank Act 2010, to form a series of applicable principles endorsed by G20 main member countries and some regions.<sup>219</sup> Hence, this part also sheds light on the approach in the United States and the United Kingdom as references.

##### A. Example 1. The US Approach

In the general corporate insolvency law, the insolvency proceeding is normally initiated by the petition of creditors or the company's management on the grounds of the cash flow test or balance sheet test, meaning that the company's liabilities exceed its asset or the company is unable to pay its debts. However, bank insolvencies in most countries, especially in the members of FSB, allow insolvency to be opened on different grounds. For example, the grounds may include some pre-insolvency capital-based triggers. The new bill of *Interim Measures for the Implementation of Recovery and Resolution Plans of Banking and Insurance Institutions* in China also mentions this point. For

<sup>218</sup> See Huang, *supra* note 199, at 884.

<sup>219</sup> See Jeremy Jennings-Mares, Anna T Pinedo & Oliver Ireland, *The Single Point of Entry Approach to Bank Resolution*, in *BANK RESOLUTION: THE EUROPEAN REGIME* 282 (Jens-Hinrich Binder & Dalvinder Singh eds., 2016).

example, the authorities need to take some measures when regulatory capital falls below a specified level.

A typical example of a hard quantitative trigger standard is the United States. In the United States, the quantitative capital trigger used by the Federal Deposit Insurance Corporation (FDIC) is specified in order to facilitate the timely opening of the proceeding and alleviate the impact of bank failures and control the responsibility of the regulators.<sup>220</sup> The resolution of FDIC allows a troubled bank place into conservatorship or receivership within 90 days of becoming “critically undercapitalized” especially when the capital ratio appears below 2% (See Table 3 below).<sup>221</sup>

TABLE 3. THE US FRAMEWORK FOR PROMPT CORRECTIVE ACTION

PCA Category	Description
Well Capitalized	Total risk-based capital ratio $\geq 10.0\%$ and tier 1 risk-based capital ratio $\geq 8.0\%$ and common equity tier 1 capital ratio $\geq 6.5\%$ and leverage ratio $\geq 5.0\%$ and not subject to any action issued by the FDIC under Section 8 of the FDI Act, the International Lending Supervision Act of 1983 (ILSA), the Home Owners’ Loan Act (HOLA), or Section 38 of the FDI Act, or any regulations thereunder, to meet and maintain a specific capital level for any capital measure. A bank subsidiary of a covered bank holding company will be deemed well-capitalized if it meets the above criteria and has a supplementary leverage ratio $\geq 6.0\%$ .
Adequately Capitalized	Total risk-based capital ratio $\geq 8.0\%$ and tier 1 risk-based capital ratio $\geq 6.0\%$ and common equity tier 1 capital ratio $\geq 4.5\%$ and leverage ratio $\geq 4.0\%$ and does not meet the definition of a well-capitalized IDI. An IDI using advanced approaches will be deemed adequately capitalized if it meets the above criteria and has a supplementary capital ratio $\geq 3.0\%$ .
Undercapitalized	Total risk-based capital ratio $< 8.0\%$ or tier 1 risk-based capital ratio $< 6.0\%$ or common equity tier 1 capital ratio $< 4.5\%$ or leverage ratio $< 4.0\%$ . An IDI using advanced approaches will be deemed undercapitalized if it has a supplementary capital ratio $< 3.0\%$ .
Significantly Undercapitalized	Total risk-based capital ratio $< 6.0\%$ or tier 1 risk-based capital ratio $< 4.0\%$ or common equity tier 1 capital ratio

<sup>220</sup> See David G. Mayes, *Early Intervention and Prompt Corrective Action in Europe*, in *THE FINANCIAL CRISIS AND THE REGULATION OF FINANCE* 159 – 160 (Christopher J. Green, Eric J. Pentecost & Tom Weyman-Jones eds., 2011).

<sup>221</sup> See *id.*

	< 3.0% or leverage ratio < 3.0%.
Critically Undercapitalized	The ratio of tangible equity to total assets $\leq$ 2.0%. (Note: tangible equity is tier 1 capital plus the amount of outstanding perpetual preferred stock (including related surplus) not included in tier 1 capital.

Source: Federal Deposit Insurance Corporation<sup>222</sup>

In China, the regulators will also consider the degree of risk to handle a bank whose capital is critically inadequate, but critical inadequacy does not trigger insolvency in most cases due to the state guarantee of banks.<sup>223</sup> As a result, although the hard quantitative boundary provides an exact threshold in dealing with bank insolvency cases, the resolution still reserves considerable discretion for regulators, and obtaining the permission of regulators is the prerequisite of initiating the bank insolvency procedure, regardless of which country is.<sup>224</sup> Empowering banking regulators with large discretion is reasonable. If the commencement isn't supposed to be allowed by the court, the process will be initiated promptly. Since dealing with bank insolvencies requires the cooperation of regulatory authorities, the involvement of the court may slow down the speed of entering bankruptcy. Furthermore, the commencement is supposed to be prudential to avoid systemic risk. In the United States, the bank insolvency regime is initiated only by the chartering agency, such as FDIC.

Initiating bankruptcy proceedings by the FDIC would also be a better choice to protect depositors. Regarding this, some scholars suggest that CDIC could be entitled to initiate the bank insolvency proceeding instead of the depositors.<sup>225</sup> In addition, the depositor guarantee scheme is required to initiate promptly. According to Article 19 of the *Deposit Insurance Regulation*, the trigger point of initiating the deposit guarantee scheme is when CDIC is appointed as a member of the take-over team or once the court issues an insolvency or liquidation order to the failed bank.<sup>226</sup> However, regarding the latest cases in Henan, it seems that this regulation could not protect depositors in a timely manner.

In contrast, the FDIC is usually informed on the condition of the troubled bank prior to the date of declaring bankruptcy, in other words, FDIC's work starts once the regulatory authorities inform the public that a bank is in

<sup>222</sup> See FED. DEPOSIT INS. CORP., FORMAL AND INFORMAL ENFORCEMENT ACTIONS MANUAL (CHAPTER 5) (2022), <https://www.fdic.gov/regulations/examinations/enforcement-actions/ch-05.pdf>.

<sup>223</sup> See Shangye Yinhang Ziben Guanli Banfa (商业银行资本管理办法) [Measures for the Capital Management of Commercial Banks of the People's Republic of China], art. 23 (Chinalawinfo); Xing, *supra* note 125.

<sup>224</sup> See Davies, *supra* note 122.

<sup>225</sup> See Wang & Chen, *supra* note 156, at 24.

<sup>226</sup> See Cunkuan Baoxian Tiaoli (存款保险条例) [Deposit Insurance Regulation] (promulgated by St. Council, Feb. 17, 2015, effective May 1, 2015), art. 19 (Chinalawinfo).

difficulties and is moving toward insolvency.<sup>227</sup> As a result, the similar functions between FDIC and CDIC make it possible to learn some lessons from the United States.

### B. Example 2. The UK Approach

The approach in the United Kingdom is more similar to the current approach in China, in which the applicants need to file for insolvency in court. The government rejected to set up a free-standing bank insolvency regime, so the approach in the United Kingdom is largely based on the procedures set out in the *Insolvency Act 1986*, but there are some modifications with specific terms for bank insolvencies. The bank administration procedure and liquidation procedure exist in the general insolvency law, *Insolvency Act 1986*. It is worth mentioning that, in principle, creditors can put a bank into administration or wind it up.<sup>228</sup>

As for the bank administration procedure, only the Bank of England can apply to the court for an administration order<sup>229</sup> on the condition of: (1) where a partial property transfer has occurred or intended to use the stabilization powers; (2) where the Bank of England identified that the residual bank is unable or likely unable to pay its debts as a result of a property transfer that the bank has made or intends to make.<sup>230</sup> The objective of the administration procedure is to support the transaction of the bank's property and businesses to the purchaser and to make sure the rescue measures achieve a better result for creditors than an immediate liquidation. The Bank of England has a central rule to achieve this objective, especially in the period of transaction banking business to private purchasers or bridge banks.

As for the bank liquidation procedure, the application for a court order and the right of appointing the liquidator can be made by the Bank of England, the appropriate regulator, or the Secretary of State.<sup>231</sup> There are two grounds for an application for an insolvency order in respect of a bank. First, a bank is unable or is likely to become unable to pay its debts.<sup>232</sup> Second, the application of bank insolvency is made in the public interest or fair.<sup>233</sup> Here, it is worth mentioning that another ground, which is not relevant to the actual or anticipated insolvency test, also needs to be considered, such as the public interest. The current Chinese approach also illustrates this point, but the key issue is there are rarely specific provisions in the relevant laws.

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<sup>227</sup> See Brainsilver, *supra* note 178, at 329.

<sup>228</sup> See Banking Liaison Panel (BLP) Subgroup on building society insolvency and special administration – Advice to HM Treasury (January 18, 2010), [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/210282/bankingliaisonpanel\\_advice180110.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/210282/bankingliaisonpanel_advice180110.pdf).

<sup>229</sup> See Banking Act 2009, §143 (UK).

<sup>230</sup> See *id.* §136(2)b (UK).

<sup>231</sup> See *id.* §95 (UK).

<sup>232</sup> See *id.* §96 (UK).

<sup>233</sup> See *id.*

Furthermore, similar to bank administration, the general rules in the *Insolvency Act 1986* are varied to give priority to the depositor's interest, which is stipulated in the objectives of the liquidation/winding-up procedure. There are two objectives of the process of winding up. The first objective is to make sure all eligible depositors have their accounts transferred to another bank or receive compensation from the Financial Services Compensation Scheme (FSCS).<sup>234</sup> Once the first objective is completed, then the process will continue to satisfy the second objective, similar to the normal liquidation procedure, which is winding up the insolvent bank in order to achieve the best result for the creditors as a whole.<sup>235</sup> These measures are similar to the Chinese approach. In Baoshang case, after the banking regulators appointed the liquidator of Baoshang Bank, the regulators first supervised the account transfers and then filed for the liquidation procedure in court. Therefore, due to the similarities between the British and the Chinese approach, it would be easier to refer to the British approach when amending the Chinese banking insolvency rules.

## VII. CONCLUSION

Thus, current rules of bank insolvencies have many ambiguities and drawbacks, and the process of updating the law is still sluggish. However, no matter how provisions of the banking resolution mechanism are modified, as long as it is difficult to initiate and execute, the mechanism is a mere scrap of paper. This explains the current situation and dilemma of the Chinese banking insolvency mechanism. Hence, making the commencement of bank insolvencies easier and more reasonable is crucial.

Given that the grounds of banking insolvency largely rely on general insolvency law, which is not suitable for banks and there is no specific banking insolvency statute in China, the regulator's administrative power dominates the whole banking insolvency process. But the prevailing attitude of the authorities is to keep banks surviving, and the government is used to subsidizing failing banks by either recapitalizing or offering state financial aid, so the commencement of bank insolvencies in China is very difficult.

As for those banks that cannot avoid insolvencies, the current solution in implementation is different from the regulations in the text. In practice, a regulator-controlled model is being followed: the banking regulator takes over the management of failing banks and disposes of some liabilities and assets first, and then under the permission of the banking regulator, the court starts the formal insolvency procedure to get rid of the rest of liabilities and the unwanted part of the bank.

The current way of the commencement of bank insolvencies causes many problems. For example, when a bank goes bankrupt in China, creditors have to wait for an event of serious default which is considered a reason for petitioning

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<sup>234</sup> See *id.* §91 (UK).

<sup>235</sup> See *id.* §99(4) (UK).



the court to place it into insolvency. Thus, the regulatory authority is the *de facto* insolvency initiator, while creditors and debtors become initiators in formality. In addition, creditors' interests are not well taken into account during the commencement of bank insolvencies in China. Although the CDIC has been set up, the interest of creditors still cannot be protected well as a whole due to the current uncompleted deposit guarantee scheme.

To make the commencement of bank insolvencies in China more efficient, two issues are supposed to be solved. First, the legacy problem needs to be eliminated, including legislative and conventional ones. In other words, it is necessary to improve the trigger standard of bank insolvency, clarify the powers standing for banking insolvency, and change the old attitude about the unwillingness of entering bankruptcy procedures. Second, to make the commencement more efficient, an appropriate mode to keep the balance between courts and administrative powers and to avoid the authorities becoming the key obstacle during the commencement needs to be found.