

The De Facto Pattern of Chinese Bank Insolvency: Discrepancies between Law and Reality

Abstract

This article offers the first in-depth analysis of the gap between China's legal framework and its practice in judicial bank insolvency proceedings. By examining recent cases, it identifies consistent patterns in how such proceedings are handled and reveals critical weaknesses in the current legal regime, including regulatory gaps and legal ambiguities that impede effective bank resolution. The study also investigates the influence of administrative powers, distinguishing between their appropriate application and instances of misuse. Based on these findings, the article proposes policy recommendations to enhance the legal framework, clarify the roles of judicial and administrative authorities, and promote a fairer and more effective insolvency process for banks in China.

1. Introduction

In terms of bank insolvency rules, there is a broad consensus that most ordinary corporate insolvency regimes are inadequate for handling bank failures, primarily due to systemic risks involved and the need of protecting depositors.¹ To address these challenges, many jurisdictions, such as the United States (US), have developed a specialised bank insolvency mechanism, known as the free-standing regime.² Others, like the United Kingdom (UK), have adapted their corporate insolvency laws and created a modified insolvency regime.³ Especially in the aftermath of the 2008 Global Financial Crisis, many jurisdictions further amended their laws to manage failing banks, incorporating special resolution tools to balance bank insolvency and financial stability.⁴

¹ Patrizia Baudino, Antonella Gagliano, Edoardo Rulli and Ruth Walters, "How to Manage Failures of Non-systemic Banks: A Review of Country Practices" (2018), Bank for International Settlements Working Paper No.10, p.7 <https://www.bis.org/fsi/publ/insights10.htm> [Accessed 11 May 2025].

² Directorate-General for Financial Stability, "Final Report—Study on the Differences between Bank Insolvency Laws and on Their Potential Harmonisation, European Commission" (2019), p.13, https://finance.ec.europa.eu/publications/study-differences-between-bank-insolvency-laws-and-their-potential-harmonisation_en [Accessed 7 May 2025].

³ For example, the UK's practice demonstrates how laws are updated, as exemplified by the Special Resolution Regime under the Banking Act 2009.

⁴ Directorate-General for Financial Stability, Final Report Study on the Differences between Bank Insolvency Laws and on Their Potential Harmonisation, European Commission (2019), p.13.

Bank insolvency proceedings in China largely rely on the general insolvency framework. Currently, bank insolvency is primarily governed by the China Enterprise Bankruptcy Law (EBL), supplemented by specific provisions in the China Banking Supervision and Administration Law (BSAL) and the China Commercial Banks Law (CBL).⁵ Additionally, the State Council and its departments have issued administrative regulations to address bank failures. For example, China's Administrative Measures for the Capital of Commercial Banks stipulates that when a bank is severely undercapitalised, the banking regulatory authorities can take measures to restructure the bank or wind it up if necessary.⁶ Other regulations also contain depositor-related provisions, such as those in China's Deposit Insurance Regulation (DIR), which supplements superior laws.⁷

However, in practice, bank insolvencies in China rarely follow the standard judicial procedures under the EBL. Instead, they are largely shaped by administrative decision-making, with financial regulators and government agencies playing a dominant role. This administrative-led approach has led to deviations from the legal framework, raising concerns about transparency, creditor protection, and the consistency of insolvency proceedings.

This article provides a critical analysis of the gap between China's legal framework and the actual practice of judicial bank insolvency proceedings. The article is structured into five sections. Following this brief introduction in Section 1, Section 2 provides an overview of China's bank insolvency legal framework. Section 3 examines recent cases to analyse the operation of bank insolvency. Section 4 highlights the gaps between law and practice based on the findings from Section 3. Section 5 is to conclude.

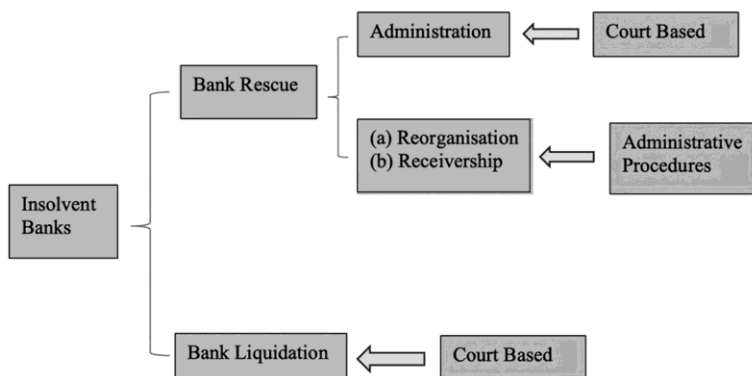
2. The legal frameworks for the Chinese Bank insolvency proceedings

Under the existing rules, China's bank insolvency framework operates through a dual-track system that combines court-led insolvency proceedings and administrative intervention mechanisms (see the Figure below).

⁵ Law of the People's Republic of China on Enterprise Bankruptcy (EBL) 2006; Law of the People's Republic of China on Commercial Banks (CBL) 2015; Law of the People's Republic of China on Banking Supervision and Administration (BSAL) 2006.

⁶ China's Administrative Measures for the Capital of Commercial Banks 2024, art.174.

⁷ China's Deposit Insurance Regulation (DIR) 2015.



Bank Insolvency Management in China (Source: Collected by the Author)

First, court-led bank insolvency proceedings under the EBL and include two primary procedures, court-based administration and liquidation:⁸

- Administration:⁹ The court appoints administrators to oversee debt restructuring and business adjustments, allowing the bank to continue operating and repaying debts. Administrators may include lawyers and/or the professionals from the banking regulatory authorities or the banking industry.¹⁰
- Liquidation: If the bank is non-viable and cannot be rescued through administration, courts can initiate the liquidation procedure to maximise creditor recoveries. Liquidators are appointed by courts to sell the bank's assets and settle debts.¹¹
- Asset distribution: Creditors repayments in liquidation follow a ranking of claims, with priority for secured creditors. Differing from the EBL, the hierarchy of unsecured claims in bank liquidation is:
 (1) liquidation expenses; (2) post-bankruptcy costs; (3) employee wages and labour insurance; (4) individual depositors (principal and interest); (5) taxes and other social insurances; and (6) other unsecured creditors, including institutional depositors.¹² For depositors, the Chinese Deposit Insurance Fund Management Corporation (DIFMC) is responsible for promptly compensating eligible depositors, up to RMB 500,000, and the gains subrogation rights in the liquidation after payment.¹³

Secondly, the government-led mechanisms, mainly based on the BSAL, the CBL, and the Administrative Measures for the Capital of Commercial Banks, allow the Chinese banking regulatory authorities to take proactive administrative

⁸ EBL 2006.

⁹ The term 'administration' is the author's own translation of the Chinese word '重整' from the EBL 2006 based on the legal context of the UK. In the legal context of the United States, this term would be translated as 'reorganisation'. Therefore, in this article, both terms are used interchangeably to convey the same meaning.

¹⁰ EBL 2006 arts 25 and 32.

¹¹ EBL 2006 art.111.

¹² CBL 2015 art.71.

¹³ DIR 2015 arts 4, 5 and 19.

measures to address failing banks.¹⁴ If intervention fails, the authorities may approve the bank's entry into the court-led liquidation.¹⁵

The capital adequacy ratio is a key trigger for government intervention in failing banks. The National Financial Regulatory Administration (NFRA) classifies banks into four categories based on compliance with the capital adequacy ratio, with different corrective actions applied as capital deteriorates.¹⁶ For instance, a bank with insufficient but not in a critical situation will face actions such as dividend restrictions and increased supervision of operations by regulators, whereas a bank deemed severely undercapitalised and at risk of insolvency will be mandated to change managers, restructure businesses or be directly taken over by the banking regulatory authorities.¹⁷ However, failure to meet the minimum capital requirement does not automatically trigger insolvency; the NFRA retains discretion to opt for restructuring through administrative means.¹⁸ These rules authorise the NFRA to intervene before formal proceedings begin, aiming to restore operations and protect depositors.

Beyond formal court-based proceedings, the current framework provides a purely administrative mechanism—receivership—under which bank management is transferred to regulators.¹⁹ It could be initiated by the banking regulators when a crisis threatens depositors or customers.²⁰ However, it remains unclear whether the 'regulators' refers solely to the NFRA or also includes the People's Bank of China (PBOC).

During receivership, although the banking regulators take over management, the bank-creditor relationship remains unchanged.²¹ Moreover, when receivership is initiated, similar to insolvency proceedings, a moratorium can be requested to temporarily halt creditor claims.²² However, unlike ordinary insolvency cases, courts must obtain the Supreme People's Court approval before granting the moratorium order.²³ Additionally, receivership is limited to two years, extendable

¹⁴ BSAL 2006; CBL 2015; China's Administrative Measures for the Capital of Commercial Banks 2024.

¹⁵ EBL 2006 art.134.

¹⁶ China's Administrative Measures for the Capital of Commercial Banks 2024 art.174: 'Based on capital adequacy status, the National Financial Regulatory Administration and its local offices shall divide commercial banks into four grades: (1) Grade I commercial banks: commercial banks which meet all the capital requirements for capital adequacy ratio, Tier 1 capital adequacy ratio, and Core Tier 1 capital adequacy ratio in these Measures; (2) Grade II commercial banks: commercial banks which fail to meet Pillar 2 capital requirements but meet all other capital requirements for capital adequacy ratio, Tier 1 capital adequacy ratio, or Core Tier 1 capital adequacy ratio; (3) Grade III commercial banks: commercial banks which meet all the minimum capital requirements but fail to meet other capital requirements for capital adequacy ratio, Tier 1 capital adequacy ratio, or Core Tier 1 capital adequacy ratio; (4) Grade IV commercial banks: commercial banks which fail to meet the minimum capital requirement for any of capital adequacy ratio, Tier 1 capital adequacy ratio, or Core Tier 1 capital adequacy ratio.'

¹⁷ China's Administrative Measures for the Capital of Commercial Banks 2024 arts 176–180.

¹⁸ BSAL 2006 art.38.

¹⁹ The term 'restructuring' in both the BSAL 2006 and the CBL 2015 differs from 'administration' or 'reorganisation' in the EBL 2006, even though they share a similar objective of rescuing banks. The existing legal framework does not explicitly outline the process of bank restructuring. However, according to Chinese academics and legal practitioners, 'bank restructuring' in these two laws extends beyond the administration procedure under the EBL 2006, granting the Chinese banking regulatory authorities' broader powers to intervene in troubled banks without court involvement, potentially preventing them from entering formal judicial insolvency procedures.

²⁰ CBL 2015 art.64.

²¹ CBL 2015 art.64.

²² EBL 2006 arts 2 and 134.

²³ Shaoping Zhu, "Some Issues on Financial Institution Insolvency" (2007) 9 *Chinese finance* 19, 20.

under force majeure (e.g. COVID-19).²⁴ If operations are not restored when the period ends, the receiver applies to court for liquidation.²⁵

In addition to receivership, regulators may adopt other flexible methods to restructure banks.²⁶ This flexibility is important as receivership is formal and time bound. In contrast, alternative measures may enable restructuring without full management takeover.²⁷ However, current rules provide no clear guidance on how regulators should participate outside of receivership—powers are broad but implementation unspecified.

To fill this gap, local governments have created restructuring strategies based on provincial circumstances. These are developed with local regulators and apply within the province.²⁸ Typically, the process involves three steps: (1) the troubled bank submits a restructuring plan (e.g. asset separation, debt restructuring, equity transfer); (2) once a consensus is reached, the provincial government seeks NFRA approval; (3) the NFRA approves with comments, which must be implemented.²⁹ For instance, in 2007, the NFRA instructed the Heilongjiang Provincial Government to oversee all bank reorganisation processes and to decide on the appointment of directors for the newly restructured banks.³⁰

Notably, the key distinction between administrative reorganisation and receivership is that in the former, regulators do not assume direct control, whereas in the latter, they do. Nonetheless, in both procedures, regulators may intervene in appointing new executives. However, not all banks undertaking administrative reorganisation or receivership are successfully rescued. If a bank fails to recover, the NFRA will permit it to enter judicial insolvency proceedings.³¹

However, the rules lack clarity on specific resolution tools during receivership. As a result, regulators must rely on discretionary, ad hoc measures. These are often not disclosed to stakeholders, with the public only accessing limited post-case reports. Therefore, critics argue these measures are politically driven and inconsistently applied.³² For example, in 2019, Jinzhou Bank, a state-linked troubled bank, received a capital injection, while Baoshang Bank, a private bank, was liquidated and its director jailed. This disparity has led to criticism of the ‘one case, one solution’ approach.³³

²⁴ CBL 2015 art.67.

²⁵ CBL 2015 art.68.

²⁶ BSAL 2006 art.38.

²⁷ Gao Yi, “Report on Financial Work by the State Council—Delivered at the 37th Session of the Standing Committee of the 13th National People’s Congress on 28 October 2022 (30 October 2022), State Council Report, <https://www.safe.gov.cn/hainan/2022/1109/1686.html> [Accessed 15 May 2025].

²⁸ Legislation Law of the People’s Republic of China 2023 art.80.

²⁹ Anhui Provincial Government, “The Proposal of Bank Restructuring Work in Anhui Province”, No.85 Government Document (September 2005); Heilongjiang Provincial Government, “The Proposal of Bank Restructuring Work in Anhui Province”, Government Document (December 2007); Shunxin Tian and Bingyu Cao, “The Study on Rural Commercial Banks Reorganisation in Hebei Province from the Perspective of Efficiency” (2023) 8 *Hebei Finance* 49, 53.

³⁰ This information is verified by the author through an anonymous interview with a lawyer in Harbin, Heilongjiang Province, on September 25, 2023.

³¹ Yuqiao Li and Yu Peng, “The Bankruptcy Procedures of the Two Banks Show that the Government’s Support for the Banking Industry Remains Strong” (2 September 2022), Fitch Bohua Research Paper, <https://fitchbohua.cn> [Accessed 21 May 2025].

³² KPMG, “2023 Survey Report of China’s Banking Industry” (May 2023), Working Report, p.195 <https://kpmg.com/cn/zh/home/insights/2023/05/china-banking-industry-survey-report-2023.html> [Accessed 16 May 2025].

³³ Mei Li and Tao Liu, “Legal Interpretation and System Enhancement of Administrative Bank Takeovers in China” (2012) 7 *Law Science Magazine* 84, 85.

In summary, while the existing rules have established a basic administrative rescue framework with greater flexibility than judicial processes, shortcomings remain. Notably, China lacks specific resolution tools such as business sales, bridge institutions, asset separation, and bail-in mechanisms.³⁴ This gap may lead to excessive regulatory intervention and difficulties balancing orderly bank exits with high rescue costs. Therefore, future reforms should aim to better regulate administrative powers to avoid misuse.³⁵

3. Enforcement of laws: an analysis of recent bank insolvency cases in China

Since the enactment of the EBL 2006, four banks in China have entered formal liquidation proceedings (see the table below). However, the insolvency of Hebei Suning Shangcun Credit Cooperative occurred before the law took effect, and its debt issues were handled by the government rather than the court. Although the bank formally entered in-court liquidation in 2011, the court quickly declared there were no assets for creditor distribution, as the government had already resolved the issue beforehand. By the time liquidation began, only four creditors remained unpaid, and therefore, the court’s role was largely symbolic, merely declaring the bank’s insolvency.

As a result, this section merely focuses on Inner-Mongolian Baoshang Bank, Liaoyang Rural Commercial Bank, and Liaoning Taizihe Rural Commercial Bank, excluding Hebei Suning Shangcun Credit Cooperative. These recent insolvencies offer insights into how laws and policies are applied in practice, revealing deviations from the legal framework.

Banks under the court-based insolvency procedure in China From 2006 to Present

Source: Collected by the Author

No.	Bank’s Name	Scale	Approval Date ³⁶	Insolvency Entry	Completion Date ³⁷	Court	Takeover Entry	Branch Acquirer
1	Liaoyang Rural Commercial	Rural Bank	4/8/2022	26/8/2022	30/12/2022	Shenyang Intermediate People’s Court	2/7/2022	Shenyang Nong-shang
2	Liaoning Taizihe	Rural Bank	3/8/2022	26/8/2022	30/12/2022	Shenyang Intermediate People’s Court	2/7/2022	Shenyang Nong-shang
3	Baoshang	City Bank	23/11/2020	23/11/2020	19/8/2021	Beijing No.1 Intermediate	24/5/2019	Meng-hang; Huishang

³⁴ This is the practice in the UK. See Michael Schillig, “Bank Resolution Regimes in Europe-Part II: Resolution Tools and Powers” (2014) 25 E.B.L.R. 67, 89.

³⁵ Qingjiang Kong and Yinghui Sun, “Chapter 19: China” in Matthias Haentjens and Bob Wessels (eds), *Crisis Management in the Banking Sector* (Edward Elgar, 2016), p.427.

³⁶ It is when the National Financial Regulatory Administration approves insolvency.

³⁷ It is the time when the bank’s insolvency procedure is completed.

No.	Bank's Name	Scale	Approval Date ³⁶	Insolvency Entry	Completion Date ³⁷	Court	Takeover Entry	Branch Acquirer
						People's Court		
4	Hebei Suning Shangcun	Rural Bank	2010 (specific date: unknown)	8/2011 (specific date: unknown)	2012 (specific date: unknown)	Cangzhou Intermediate People's Court	No (The bank has closed since 2001)	No

3.1 The insolvency process of Baoshang Bank Ltd

As the first bank insolvency case following the enactment of the EBL and the DIR, Baoshang Bank failed mainly due to reasons. One reason is its poor corporate governance. According to NFRA regulations, major shareholders of medium-sized commercial banks cannot hold over 20% of shares.³⁸ However, Tomorrow Group, Baoshang's controlling shareholder, indirectly held 89.27%, allowing it to dominate shareholder meetings, override opposition, and exploit the bank's resources.³⁹ On the day when Baoshang Bank was taken over by the banking regulatory authorities, Tomorrow Group had fraudulently obtained a loan of around RMB 150 billion from the bank, causing a severe credit crisis.⁴⁰

The other reason for the bank's insolvency relates to its unsustainable business model. Baoshang heavily lent to SMEs in retail and manufacturing, but China's slowing growth post-2015 led to rising non-performing loans.⁴¹ To maintain liquidity, it relied heavily on interbank lending and issued many certificates of deposit. By 2014, its interbank debt ratio hit 32.1%, well above the PBOC's one-third cap, and rose to 52.7% by September 2017.⁴² Meanwhile, its ability to attract deposits declined, worsening financial distress.⁴³

Under such circumstances, the bank became insolvent. Below is a brief timeline of the resolution process.⁴⁴

- 24 May 2019: Baoshang was placed under administrative receivership by the NFRA and PBOC.⁴⁵

³⁶ It is when the National Financial Regulatory Administration approves insolvency.

³⁷ It is the time when the bank's insolvency procedure is completed.

³⁸ Measures for the Administration of Chinese Financial Enterprise Groups 2022, art.8.

³⁹ Changyi Li, Wenjie Ou, Tengfei Wu, Jingnan Xiao, Lizhou Xiao, Juhao Zhang and Yingying Zhou, "Baoshang Bank's Corporate Governance and Its Rescue" (26 December 2022), Qinghua Finance MBA Research Paper, <http://fmbs.pbcfs.tsinghua.edu.cn/info/1027/3389.htm> [Accessed 23 May 2025].

⁴⁰ Xuedong Zhou, "Financial risks in Small and Medium-sized Banks Primarily Arise from Failures in Corporate Governance" (2020) 15 *China Finance* 19, 19.

⁴¹ "The Baoshang Insolvency Case" (This article is published by an anonymous lawyer who participated the Baoshang insolvency case at a WeChat Account on 10 June 2023), <https://mp.weixin.qq.com/s/GN4yuakw5USpwh4yY3tHIA> [Accessed 11 May 2025]; Yangyun Su, "China's GDP Growth Rate Hit a 25-year Low of 7% in 2015, and the Country Continues to Face Downward Economic Pressure this Year" (Reuters, 19 January 2016), <https://www.reuters.com/article/world/china/2015gdp25--idUSKCN0UX09E/> [Accessed 23 May 2025].

⁴² PBOC, NFRA, China Securities Regulatory Commission (CSRC), and State Administration of Foreign Exchange (SAFE), "Notice on Regulating Interbank Business of Financial Institutions" (2014), No.127 Document, art.14.

⁴³ The data is sourced from the Baoshang Bank 2014–2017 Annual Reports, obtained by lawyers, and provided to the author.

⁴⁴ All information is collected by the author from the official website of the National Financial Regulatory Administration and the National Enterprise Bankruptcy Information Disclosure Platform.

⁴⁵ On 18 May 2023, the China Banking and Insurance Regulatory Commission changed its name to the National Financial Regulatory Administration.

- 30 April 2020: Huishang Bank acquired branches outside Inner Mongolia.
- 20 May 2020: Mengshang Bank acquired Inner Mongolia branches.
- 11 November 2020: PBOC and NFRA wrote down capital bonds.
- 17 November 2020: Baoshang filed for insolvency in the Beijing First Intermediate People's Court.
- 23 November 2020: Court accepted the case and appointed a liquidation committee.
- 12 January 2021: First creditors' meeting held.
- 7 February 2021: Court declared reorganisation impossible; bank entered winding up.
- 5 August 2021: Liquidators applied to terminate winding up due to no distributable assets.
- 19 August 2021: Court approved the termination of the insolvency proceeding.

From the above timeline, it is evident that Baoshang Bank first underwent administrative receivership then entering the winding-up process. The regulators made this arrangement due to the following considerations:

First, Baoshang served over 4.67 million individual depositors, 30,000 SMEs, 33,600 institutional depositors, and 200,000 investment product customers. The government stepped in to maintain basic services.⁴⁶

Secondly, Baoshang Bank had 18 branches across key cities and 10,171 employees.⁴⁷ Insolvency would cause massive job losses, so regulators aimed to protect social stability by maintaining operations and directing Huishang and Mengshang Banks to absorb its staff and offices.⁴⁸

Thirdly, Baoshang Bank's interbank liabilities were reported to exceed RMB 300 billion, involving around 700 institutions.⁴⁹ Huishang Bank alone was reported to have an exposure of about RMB 6 billion.⁵⁰ Some argue that regulators feared liquidation would yield minimal recovery, prompting them to manage the crisis through receivership.⁵¹

Notably, Baoshang Bank's significant interbank liabilities and poor financial performance were known among banking lawyers for years.⁵² However, Chinese banking regulators seemed unaware and did not impose penalties until the situation became critical. Furthermore, Baoshang Bank had not released its annual financial reports for two years before being taken over, yet the banking regulatory authorities failed to take effective action.⁵³ The reason for this situation is likely that Jianhua

⁴⁶ Xuedong Zhou, "After Baoshang Bank Was Liquidated, Did the Depositors Get Their Money Back?" *163 News* (7 May 2022), <https://www.163.com/dy/article/H6Q4DVN30539E5LQ.html> [Accessed 21 June 2024].

⁴⁷ Financial Stability Bureau of the PBOC, "China Financial Stability Report" (2021), p.79.

⁴⁸ Yu Wu, "PBOC: It is Planned to Establish Mengshang Bank to Acquire and Undertake the Business of Baoshang Bank in Inner Mongolia Autonomous Region", *Xinhua News* (10 April 2020), https://www.gov.cn/xinwen/2020-04/10/content_5501179.htm [Accessed 21 June 2025].

⁴⁹ Financial Stability Bureau of the PBOC, "China Financial Stability Report" (2021), p.81.

⁵⁰ Xiaona Zhou, "Behind RMB17.7 Billion of Acquisition expense, Huishang Bank Has Lost RMB 6 Billion" *Sina News* (30 November 2020), <https://finance.sina.com.cn/stock/s/2020-11-30/doc-iiznctke4086207.shtml> [Accessed 21 June 2025].

⁵¹ Qizhong Qu, "Baoshang Bank Serves as a Successful Case Study in Managing Systemic Financial Risks" *Sohu News* (21 December 2020), https://www.sohu.com/a/439635800_115571 [Accessed 20 June 2025].

⁵² This information was collected by the author from the anonymous interviews with lawyers in China.

⁵³ Based on the same set of anonymous interviews with lawyers in China.

Xiao, the actual controller of Baoshang Bank, had close ties with many senior government officials, which may have led to the bank's violations not being penalised.⁵⁴ This also highlights a weakness in China's banking regulatory system, where regulators sometimes struggle to take decisive action against banks with political connections or ties to the government.

Based on the considerations mentioned above, regulators took the following measures in the bank's insolvency process:

- **Early compensation:** Deposit payouts began at the receivership stage, even though law requires court-initiated insolvency first. This showcased the flexibility of administrative authority.⁵⁵
- **Full compensation:** To prevent social unrest, regulators were reported to have compensated individual depositors in full, rather than applying the statutory cap of RMB 500,000. Institutional depositors also received compensation well beyond the legal limit.⁵⁶
- **Interbank claim coverage:** Interbank claims under RMB 50 million were fully compensated by deposit insurance funds; larger ones partially.⁵⁷ Overall, about 90% of interbank claims were covered using deposit insurance funds, despite violating art.4 of the DIR, sparking controversy.⁵⁸
- **Asset separation:** The valuable assets were transferred to Mengshang Bank (a newly established state-owned bank) and Huishang Bank (one of Baoshang Bank's creditors), whereas the toxic assets went into liquidation.⁵⁹ This arrangement raised concerns over the opaque selection of merger parties. Specifically, the decision to allow one of Baoshang Bank's creditors to convert its claims into equity in the newly restructured bank should have followed the principles of fair creditor treatment under the EBL.⁶⁰ It should have been market-driven, providing equal opportunities for all creditors.⁶¹ The reason is that this arrangement can bring significant value to the mergers, as China has strict restrictions on banks attracting depositors from outside their regions.⁶² For instance, once Huishang Bank

⁵⁴ Michael Forsythe, Katrina Northrop and Eliot Chen, "Chinese Billionaire Criminal Secretly Profited off Jack Ma's deals" *New York Times* (22 July 2024), https://www.nytimes.com/2024/07/21/world/asia/jack-ma-xiao-jianhua.html?unlocked_article_code=1.800.gPXA.jOYhA2d7QbFC&smid=em-share [Accessed 21 May 2025]; "Making Sense of Xiao Jianhua's Empire", *The Wire China* (21 July 2024), <https://www.thewirechina.com/2024/07/21/making-sense-of-xiao-jianhuas-empire/> [Accessed 21 May 2025].

⁵⁵ DIR 2015 art.19.

⁵⁶ Samuel Shen Brenda Goh and Cheng Leng, "Chinese Regulators will Restructure Baoshang Bank as Soon as Possible" (Shanghai: Reuters, 16 June 2019), <https://www.reuters.com/article/business/chinese-regulators-will-restructure-baoshang-bank-as-soon-as-possible-idUSKCN1TH0C8/> [Accessed 21 May 2024]; "Understanding the Baoshang Insolvency Case: Is it the First and the Last Case in the Past 20 Years?" *Sina News* (28 May 2019), <http://finance.sina.com.cn/stock/re/news/hk/2019-05-28/doc-ihvnews5170483.shtml> [Accessed 26 June 2025].

⁵⁷ Financial Stability Bureau of the PBOC, "China Financial Stability Report" (2021), p.80.

⁵⁸ DIR 2015 art.4.

⁵⁹ Financial Stability Bureau of the PBOC, "China Financial Stability Report" (2021), p.81.

⁶⁰ EBL 2006 art.1.

⁶¹ Xinxin Wang, "Debt-to-equity Swaps of Commercial Banks in Enterprise Reorganisation" (2017) 2 *Journal of Renmin University of China* 2, 10.

⁶² Fangran Wang, "Despite Repeated Warnings from Regulators, Some Small and Medium-sized Banks Continue to Attract Deposits with High Interest Rates and Illegally Expand Their Operations" *No.1 Finance* (Beijing: 12 February 2023), <https://m.yicai.com/news/101672524.html> [Accessed 21 June 2025].

merges with Baoshang Bank's offices in other regions, it will be able to attract more depositors.⁶³ Notably, to facilitate these processes, all restructuring costs were covered by deposit insurance funds.

- **Formal liquidation:** After addressing the aforementioned issues, the NFRA finally approved Baoshang Bank's entry into formal liquidation and appointed the liquidation committee to oversee the process.⁶⁴ The members of the liquidation committee were the same as those in the takeover team, mainly consisting of officials from the NFRA, the PBOC, and a group of lawyers.⁶⁵ At this stage, no assets remained for distribution, leaving 728 creditors unpaid.⁶⁶ Some had already been compensated during the earlier stage, leading to inconsistency and potential violation of the *pari passu* principle. With no judicial review mechanism available, creditors had no avenue to challenge the outcome.

3.2 *The insolvency process of Liaoyang Rural Commercial Bank Ltd and Liaoning Taizihe Rural Commercial Bank Ltd*

Unlike Baoshang Bank, Liaoning Taizihe Rural Commercial Bank and Liaoyang Rural Commercial Bank, both located in Liaoyang City, Shenyang Province, were smaller institutions with no branches outside their cities. For simplicity, this section refers to them as 'Taizihe' and 'Liaoyang' respectively.

Their insolvencies stemmed from similar causes as Baoshang Bank, particularly poor corporate governance and regulatory oversight.⁶⁷ Liaoyang's failure was mainly due to its major shareholders being controlled by Zhongwang Group, which resulted in the illegal issuance of numerous loans to Zhongwang Group and its subsidiaries.⁶⁸ However, the NFRA caps loans to the top ten customers at 50% of the bank's net capital, while Liaoyang exceeded this, reaching 61.51% in 2016 and 83.93% in 2019, further worsened by internal corruption.⁶⁹

Similar to Baoshang Bank, the banking regulators failed to act for years. When Zhongwang faced financial trouble in 2021 and planned to file insolvency, Liaoyang suffered significant credit risk. Then, Liaoyang's insolvency triggered Taizihe's

⁶³ "Huishang Bank: Net Profit Expected to Reach RMB 15 Billion in 2023, Up 9.56% from Last Year" (21 March 2024), <https://24h.jrj.com.cn/2024/03/21222539943991.shtml> [Accessed 21 June 2025].

⁶⁴ The First Intermediate People's Court of Beijing Municipality, "Verdict of the Acceptance of Filing for Insolvency of Baoshang Bank Co Ltd" (23 November 2020), <https://pccz.court.gov.cn/pcajxxw/pcgg/ggqx?id=A0DD1BE17A3F3F8A086F55462B5ADA28> [Accessed 9 February 2025].

⁶⁵ This information was collected by the author through an anonymous interview with a lawyer on August 29, 2023.

⁶⁶ The First Intermediate People's Court of Beijing Municipality, "Verdict of the Competition of Liquidation of Baoshang Bank Co Ltd" (19 August 2021), <https://pccz.court.gov.cn/pcajxxw/pcgg/ggqx?id=173BC4DDB55F9708AFA064A6B1BE90A2> [Accessed 20 March 2025].

⁶⁷ Binbin Sun, "Understanding the Bankruptcy Proceedings of Liaoyang Rural Commercial Bank" (29 August 2022), Tianfeng Securities Research Paper, <https://mp.weixin.qq.com/s/oSuD77maoYUxzf-825iLw> [Accessed 21 June 2025].

⁶⁸ Binbin Sun, "Understanding the Bankruptcy Proceedings of Liaoyang Rural Commercial Bank" (29 August 2022), Tianfeng Securities Research Paper.

⁶⁹ Regulatory Opinions on CBL 2015 art.39; Zheming Zhang, Mokun Ma and Xu Zhang, "Transformation: The New Process of Reform of Rural Financial Institutions" (2022), China Lianhe Credit Rating Co Ltd Research Paper, p.10.

failure, since Liaoyang held a 49% stake in Taizihe.⁷⁰ Both cases were jointly handled by the Shenyang Intermediate People's Court, with the following timeline:

- 21 June 2022: The NFRA approved the establishment of the Liaoyang Branch of Shenyang Rural Commercial Bank in preparation for the merger of Liaoning Taizihe Rural Commercial Bank and Liaoyang Rural Commercial Bank.⁷¹
- 2 July 2022: Assets and employees of both banks were transferred to Shenyang Rural Commercial Bank under the NFRA supervision.⁷²
- 3 August 2022: The NFRA approved formal insolvency.⁷³
- 26 August: Court accepted the case and appointed administrators.⁷⁴
- 26 September: First creditors' meeting held.
- 22 December: Court declared the banks formally in liquidation.⁷⁵
- 23 December: Second creditors' meeting held.
- 30 December: Court terminated the winding-up process.⁷⁶ No repayment data was disclosed.

Unlike Baoshang Bank, which was first taken over by the regulators before entering formal insolvency proceedings, Taizihe and Liaoyang proceeded directly into formal judicial insolvency after receiving NFRA approval. The key reason for this difference is their small size, limited number of depositors and staff, and minimal interbank debts, which meant less concern over systemic risks.⁷⁷

Notably, it has been reported that before formal proceedings, regulators transferred operations and personnel to Shenyang Rural Commercial Bank, with

⁷⁰ Sun, "Understanding the Bankruptcy Proceedings of Liaoyang Rural Commercial Bank" (29 August 2022), Tianfeng Securities Research Paper, <https://mp.weixin.qq.com/s/oSuD77maoYUxf-825ItLw> [Accessed 21 June 2025].

⁷¹ NFRA Liaoyang Bureau, "Liaoyang Branch of the CBIRC Approves Opening of Shenyang Rural Commercial Bank Co., Ltd., Liaoyang Branch", No.6 NFRA Document (2022), <https://www.nfra.gov.cn/branch/liaoning/view/pages/common/ItemDetail.html?docId=1057551&itemId=1701&generaltype=0> [Accessed 26 June 2025].

⁷² The Liaoning Provincial Bank Union Office released two notices without specific titles on its website on 2 July 2022, <http://www.lnrcc.com/c/2022-07-03/525606.shtml> and <http://www.lnrcc.com/c/2022-07-03/525605.shtml> [Accessed 26 June 2025].

⁷³ NFRA, "CBIRC's Response Regarding the Insolvency of Liaoning Taizihe Rural Bank Co., Ltd.", No. 554 NFRA Document (2022),

<https://www.nfra.gov.cn/cn/view/pages/governmentDetail.html?docId=1069586&itemId=868&generaltype=1> [Accessed 27 August 2025]; NFRA, "CBIRC's Response Regarding the Insolvency of Liaoyang Rural Commercial Bank Co., Ltd.", No.453 NFRA Document (2022), <https://www.nfra.gov.cn/cn/view/pages/ItemDetail.html?docId=1069563&itemId=4110&generaltype=1> [Accessed 27 August 2025].

⁷⁴ Liaoning Province Shenyang Intermediate People's Court, "Verdict of the Acceptance of Filing for Insolvency of Liaoyang Rural Commercial Bank Co. Ltd." (26 August 2022), <https://pcz.court.gov.cn/pcajxxw/pcws/wsxx?id=5A3168D5A5674E230FAB151C0E7EE58A> [Accessed 20 March 2025]; Liaoning Province Shenyang Intermediate People's Court, "Verdict of the Acceptance of Filing for Insolvency of Liaoning Taizihe Bank Co. Ltd." (26 August 2022), <https://pcz.court.gov.cn/pcajxxw/pcgg/ggxx?id=BBAE195247CD4004826476731B38377E> [Accessed 14 March 2025].

⁷⁵ Liaoning Province Shenyang Intermediate People's Court, "Verdict on the Declaration of Insolvency of Liaoyang Rural Commercial Bank Co., Ltd." (22 December 2022), <https://pcz.court.gov.cn/pcajxxw/pcgg/ggxx?id=10760F1925CDBBAC5B6B3EBDF72305A6> [Accessed 26 June 2025]; Liaoning Province Shenyang Intermediate People's Court, "Verdict on the Declaration of Insolvency of Liaoning Taizihe Bank Co. Ltd." (22 December 2022). This document was formerly accessible via the official website but is no longer available online; a copy is on file with the author.

⁷⁶ Liaoning Province Shenyang Intermediate People's Court, "Announcement of Termination of Bankruptcy Proceedings" (30 December 2022), <https://pcz.court.gov.cn/pcajxxw/pcgg/ggxx?id=0F7FC0BAC13547DBCABE43AF953972E2> [Accessed 27 August 2025].

⁷⁷ Since Liaoyang has not disclosed its annual report since 2019, the number of its employees and depositors at the time of insolvency is unknown. However, according to the 2019 annual report, Liaoyang had 554 employees. In addition, although the exact number of employees at Taizihe is not disclosed, it is assumed to be fewer than at Liaoyang, as Taizihe is classified as a small rural bank, the smallest type in the Chinese banking classification. In addition, the information was verified by the author from an anonymous interview.

costs said to have been covered by local government and deposit insurance funds.⁷⁸ This reflects China's reliance on administrative measures due to gaps in its legal framework, particularly the absence of clear bank stabilisation tools. Since the EBL and DIR came into effect, it has been reported that three bank insolvencies have occurred, all during periods of economic downturns, highlighting the role of administrative intervention in maintaining confidence.⁷⁹

However, controversy surrounds the choice of Shenyang Rural Commercial Bank to take over and merge the failed banks. While Fitch Bohua argued it was due to geographic proximity and familiarity, many other local banks were available. Shenyang Rural Commercial Bank's selection was likely influenced by its major shareholder, Liaoning Energy Group, owned by the provincial government.⁸⁰ This suggests political interests shaped the merger, enabling Shenyang Rural Commercial Bank to expand into Liaoyang and potentially gain from the deal.⁸¹

This is supported by the Shenyang Rural Commercial Bank's 2021 report, which revealed a RMB 29 million net loss and a capital adequacy ratio of just 7.1%—below the 10.5% standard.⁸² Moreover, its shareholders were reportedly linked to misconduct, with some under investigation or having frozen assets.⁸³ Despite this, regulators arranged the merger and provided significant financial support, indicating a top-down administrative approach rather than market-driven selection.

However, proponents argue this allowed the provincial government to secure central funds and resolve all three banks simultaneously. Still, this approach may not be cost-effective, potentially excluding market participants better suited to the task.⁸⁴ Thus, regulators is supposed to consider fairer, more efficient alternatives in future bank resolutions.

Like Baoshang, the NFRA only approved winding-up after pre-arrangements were complete. The court-appointed liquidation committee was led by a senior provincial official, with members from municipal governments and Party committees.⁸⁵ This hierarchy suggests the committee may hold greater sway than the court itself, especially on sensitive matters like layoffs and depositor compensation. Finally, aside from the confirmation that no secured creditors were

⁷⁸ Shiqing Xiao, "The Branches of Liaoyang Nongshang Bank and Another Bank are Taken Over by Shenyang Rura Commercial Bank", *Daily Economic News* (5 July 2022), <https://baijiahao.baidu.com/s?id=1737434230311943897&wfr=spider&for=pc> [Accessed 13 February 2025].

⁷⁹ Casey Hall, "For Many in China, the Economy Feels Like It Is in Recession" (Shanghai: Reuters, 11 March 2024), <https://www.reuters.com/world/china/many-china-economy-feels-like-it-is-recession-2024-01-17/> [Accessed 21 June 2025].

⁸⁰ Li and Peng, "The Bankruptcy Procedures of the Two Banks Show that the Government's Support for the Banking Industry Remains Strong" (2 September 2022), Fitch Bohua Research Paper.

⁸¹ *Ibid.*

⁸² *Ibid.*

⁸³ Kang Li, "Shenyang Rural Commercial Bank Acquires Two Banks in Liaoyang City, Enhancing Regional Integration" *Business News Magazine* (20 July 2022), <https://www.163.com/dy/article/HCNB702J0550ASNM.html> [Accessed 21 June 2025].

⁸⁴ This information was collected by the author through an anonymous interview with a judge on 12 September 2023 in Shenyang, Liaoning Province.

⁸⁵ Liaoning Province Shenyang Intermediate People's Court, "Decision of the Liaoning Province Shenyang Intermediate People's Court to Appoint the Liquidators" (26 August 2022), <https://pczc.court.gov.cn/pcajxcw/pcws/wsxq?id=3E73CA957E439EAE027AA50B94473C8B> [Accessed 13 June 2025].

involved, details about creditor numbers and repayments, including outcomes for unsecured creditors, remain undisclosed.

4. Findings from the differences between Law and Practice

Building on the detailed analysis of legal rules and insolvency cases in the preceding discussion, the process of bank insolvencies in China deviates significantly from the legal framework. Therefore, this section examines the real pattern of bank insolvency in China and its weaknesses.

4.1 The real pattern of China's Bank insolvency proceedings: similarities among the three cases

Under the current legal framework, the bank insolvency proceedings commence when the court, with approval from the NFRA, initiates a process that includes administration, reconciliation, or liquidation.⁸⁶ This was affirmed by the First Intermediate People's Court of Beijing in the Baoshang Bank case, where no application for judicial administration or reconciliation was filed at the first creditors' meeting, allowing liquidation to proceed.⁸⁷ However, an analysis of three bank insolvency cases in China shows that actual practices deviate from the EBL. In practice, bank insolvency typically follows a simplified two-stage process: administrative resolution followed by in-court liquidation, with judicial administration or reconciliation never applied.

The administrative resolution phase, led by banking regulators, aims to keep the bank operational while facilitating restructuring. Restructuring occurs through capital injection or merger to save the bank, or asset transfers to other banks, with the remainder prepared for liquidation. This stage is purely administrative, involving regulators, local governments, and central government guidance and funding. Political considerations also influence decisions, as regulators may act beyond legal provisions to preserve social stability. However, such interference may compromise creditors' rights, as seen with some unsecured creditors of Baoshang Bank.

The subsequent judicial phase often involves little value left for distribution, as key assets are transferred beforehand. This stage mainly serves to convene a creditors' meeting and inform unpaid creditors about the remaining assets. For example, Baoshang Bank had no assets left for unsecured creditors upon liquidation.⁸⁸ While outcomes for the other two banks remain unclear, the court lacks authority to overturn decisions made during the administrative phase, leaving unpaid creditors in a weak position.

In summary, China's current practice of resolving bank failures through administrative measures followed by court-led liquidation reflects a lack of confidence in the judiciary's ability to manage failed banks. This approach is not exclusive to China. Many countries adopted similar strategies during the early stages of banking crises, where regulatory authorities effectively controlled the

⁸⁶ EBL 2006 arts 7 and 134.

⁸⁷ The First Intermediate People's Court of Beijing Municipality, "Verdict of the Competition of Liquidation of Baoshang Bank Co Ltd" (19 August 2021).

⁸⁸ Ibid.

process even when court procedures were in place.⁸⁹ To uphold social stability and maintain public confidence, the Chinese government has occasionally taken actions that go beyond the scope of existing legal frameworks. A similar situation occurred in the UK during the early phase of the Global Financial Crisis. In 2007, the British government provided a full guarantee to depositors of Northern Rock Bank due to limited public trust in the existing deposit compensation system.⁹⁰ At that time, the UK operated a co-insurance model, which offered full protection for the first £2,000 of deposits and 90 percent coverage for the next £33,000.⁹¹ This meant that a depositor could potentially lose up to £3,300. Against this background, most of the measures taken by the Chinese banking regulators in the Baoshang Bank case appear reasonable, especially considering the long-standing policy tradition of providing full guarantees to depositors when a bank fails.⁹²

4.2 Weaknesses in the existing legal framework for China's judicial bank insolvency proceedings

Under the current legal framework, apart from the rules concerning the appointment of office holders and the hierarchy of asset distribution, the administration and winding up rules for banks are identical to those for non-bank companies. This approach arguably fails to address the unique complexities of banks. Specifically, current legal framework lacks detailed guidance on the role of banking regulators in administration and winding up, and it does not clarify how courts and regulators should coordinate during these proceedings.⁹³

Moreover, there are no specific provisions for managing issues unique to bank insolvency, such as transferring depositors' accounts or minimising the broader impact on the financial system. For example, in other jurisdictions, there are clear provisions requiring bank administrators or liquidators to prioritise certain objectives, such as implementing stabilisation measures, at the request of the banking regulator before fulfilling general insolvency objectives.⁹⁴ In particular, compared to the international standards set by the Financial Stability Board, some stabilisation options are either missing or ambiguous under the current legal framework in China. For example, there are no detailed rules outlining how to 'achieve continuity of systemically important functions by way of a sale or transfer of the shares in the firm or of all or parts of the firm's business to a third-party, either directly or through a bridge institution, and/or an officially mandated creditor-financed recapitalisation of the entity that continues providing the critical functions' in China.⁹⁵ As a result, the absence of tailored provisions for banks

⁸⁹ Jens-Hinrich Binder, Michael Krimminger, Maria J. Nieto and Dalvinder Singh, "The Choice Between Judicial and Administrative Sanctioned Procedures to Manage Liquidation of Banks: A Transatlantic Perspective" (2019) 14 *Capital Markets Law Journal* 178, 194.

⁹⁰ Andrew Campbell and Peter Cartwright, "Co-insurance and Moral Hazard: Some Reflections on Deposit Protection in the UK and USA" (2003) 5 *Journal of International Banking Regulation* 9, 11.

⁹¹ *Ibid.*

⁹² PBOC, "China Monetary Policy Implementation Report Q2 2020" (Monetary Policy Analysis Group, 6 June 2020), p.22.

⁹³ Shuguang Li, "Promote the Revision of the EBL2006 and Improve Financial Institution Insolvency Regime" (2020) 2 *Tsinghua Finance Review* 19, 20.

⁹⁴ This is the practice in the UK, as outlined in the Banking Act 2009 ss.7 and 147.

⁹⁵ Financial Stability Board, "Key Attributes of Effective Resolution Regimes for Financial Institutions Revised Version", Policy Document (2024), p.7, <https://www.fsb.org/2024/04/key-attributes-of-effective-resolution-regimes-for-financial-institutions-revised-version-2024/> [Accessed 15 December 2025].

creates challenges in applying the existing rules, making some processes somewhat theoretical and less practical.

Under these circumstances, a key challenge is the uncertainty in coordinating between the BSAL and the EBL. This raises the question of whether the administrative reorganisation outlined in art.38 of the BSAL can replace the formal administration process specified in the EBL.⁹⁶ Although both models aim to achieve bank restructuring, they differ in their approaches. The EBL 2006 mandates that any restructuring plan prepared by the failed bank and its administrator must receive court approval.⁹⁷ In contrast, administrative reorganisation rules permit local governments to fully take on the role of the court in this process. Therefore, legal adjustments to clarify the distinction between the two approaches appear necessary. Under such circumstances, many Chinese scholars suggest adopting rules from the American model to transform the restructuring and insolvency of failed banks into a purely administrative process, thereby addressing the unclear division between administrative reorganisation and judicial administration in China.⁹⁸

Given the disconnect between the administrative and judicial processes, an important question arises regarding whether administrative resolution is necessary in all bank insolvency cases. While existing rules allow for administrative intervention in the case of failed banks, they do not require it as a mandatory step in insolvency proceedings.⁹⁹ It is therefore important to consider whether the law should incorporate resolution tools specifically designed for large, complex, and international banks to minimise unnecessary intervention by administrative authorities. In contrast, for banks deemed to be of ‘no public interest’ or posing a ‘systemic risk’, the law is supposed to consider directly entering traditional insolvency procedures. Thus, there is ongoing debate about whether a public interest test should be introduced to decide between the two bank restructuring models in the current legal framework.¹⁰⁰

Another challenge stems from the potential conflict between policy and law. For instance, the objective of winding up is generally to settle the bank’s affairs in a way that achieves the best outcome for all creditors.¹⁰¹ However, if the existing policy allows some creditors to be repaid beyond legal limits before the judicial insolvency proceedings begin, those creditors who do not receive preferential treatment will still face unfairness, even if they are repaid during the liquidation process. Therefore, regarding the current pattern in China, an important issue is ensuring that bank resolution fairly treats all stakeholders. Losses should be borne

⁹⁶ BSAL 2006 art.38; EBL 2006 art.2.

⁹⁷ EBL 2006 art.79.

⁹⁸ Jason A. Lien and Julian C. Zebot, “FDIC Receivership and Bank Litigation: What Litigators and Their Clients Need to Know” (2010) 6 *Pratt’s Journal of Bankruptcy Law* 593, 595; Zhongyan Ji, “Research on the Relationship Between the Central government and Local Governments in Financial Risk Disposal in the Banking Sector” (2023) 1 *Financial Regulation* 42, 46; Xutan Xie, “The Lessons from the Bankruptcy Event in the US for the Stability of Guangdong’s Financial System” (2024) 1 *Guangdong Economy* 22, 23.

⁹⁹ BSAL 2006 art.38; CBL 2015 art.64.

¹⁰⁰ Jens-Hinrich Binder, “Proportionality at the Resolution Stage: Calibration of Resolution Measures and the Public Interest Test” (2020) 21 *European Business Organisation Law Review* 453, 474.

¹⁰¹ Rodrigo Olivares-Caminal, John Douglas, Randall Guynn, Alan Kornberg, Sarah Paterson, and Dalvinder Singh, “Part II Bank Resolution, Banking Act Restructuring and Insolvency Procedures” in Rodrigo Olivares-Caminal AK, Sarah Paterson, John Douglas, Randall Guynn and Dalvinder Singh (eds), *Debt Restructuring*, 2nd edn (Oxford University Press, 2016), p.7.62.

mainly by bank owners and investors, and creditors' benefits in the resolution process should not be less than those in traditional insolvency liquidation.¹⁰²

In addition, in cases of bank insolvencies where administrative authorities have already taken actions before the formal insolvency process, courts in China do not have the authority to overturn or alter decisions made by government-appointed office holders. Furthermore, given that the liquidation committee in bank insolvencies is typically determined by the government and mainly consists of government officials, it is reasonable to conclude that the court's power is quite limited in bank insolvency cases.

4.3 Administrative powers in bank insolvencies in China: appropriate or abusive?

Given the importance of the banking system to China's economy and financial system, it is reasonable for the Chinese government to intervene in bank insolvencies.¹⁰³ In cases of bank insolvency, the government works to minimise the impact on the financial industry and society. For example, during the resolution of Baoshang Bank's failure, the government made every effort to ensure that deposits and interbank liabilities were unaffected.¹⁰⁴ In addition, in the cases of two bank insolvencies in Liaoning Province, the interests of all depositors and other bank customers were safeguarded.¹⁰⁵ These demonstrate the government's strong support for banks, aiming to protect depositors and bondholders during a banking crisis.¹⁰⁶

Notably, the level of government support varies with the size of the bank. For medium-sized banks, such as Baoshang Bank, the support is more substantial compared to that provided to smaller banks. Fitch Bohua notes that government support for smaller banks currently focuses mainly on protecting deposits and employees, but predicts that in the future, support might extend to interbank liabilities and capital bonds in the wholesale market. Fitch Bohua also points out that, although the government announced a full write-down of all capital bonds in the wholesale market during Baoshang Bank's insolvency, it is expected that if larger banks with greater systemic importance declare insolvent in the future, the government might support or repay capital bonds.

However, some critics argue that the government's support for banks during failures is excessive, particularly in extending protection to institutional depositors and certain unsecured creditors beyond what is legally required.¹⁰⁷ They claim this continues the longstanding practice of providing a 'state guarantee' for banks.¹⁰⁸

¹⁰² Binder, Krimminger, Nieto and Singh, "The Choice Between Judicial and Administrative Sanctioned Procedures to Manage Liquidation of Banks: A Transatlantic Perspective" (2019) 14 *Capital Markets Law Journal* 178, 179.

¹⁰³ Li and Peng, "The Bankruptcy Procedures of the Two Banks Show that the Government's Support for the Banking Industry Remains Strong" (2 September 2022), Fitch Bohua Research Paper.

¹⁰⁴ Financial Stability Bureau of the PBOC, "China Financial Stability Report" (2021), p.81.

¹⁰⁵ Sun, "Understanding the Bankruptcy Proceedings of Liaoyang Rural Commercial Bank" (29 August 2022), Tianfeng Securities Research Paper.

¹⁰⁶ Li and Peng, "The Bankruptcy Procedures of the Two Banks Show that the Government's Support for the Banking Industry Remains Strong" (2 September 2022), Fitch Bohua Research Paper.

¹⁰⁷ Jieche Su, "Costs Sharing for Resolving Insolvent Banks" (2022) 5 *Journal of Xiamen University* 112, 121.

¹⁰⁸ *Ibid.*

In response, regulators assert that, while they have provided support for certain bank debts during insolvencies, the overarching principle remains that the state will not offer unlimited guarantees for banks but will only protect the interests of vulnerable creditors.¹⁰⁹

Furthermore, the handling of the insolvencies of Liaoning Taizihe Rural Commercial Bank and Liaoyang Rural Commercial Bank suggests that local governments may have misused their powers during the merger and restructuring processes. This underscores the deficiencies in the current banking regulatory framework. The absence of adequate legal rules means there are few limits on regulators' powers. As a result, in some bank resolution cases, the acquirers of failed banks were selected based on political demands rather than their qualifications. Meanwhile, public funds have been excessively used to facilitate the merger and acquisition process and to compensate creditors who should not have been protected. This approach not only contradicts international principles regarding bank resolution costs but also intensifies moral hazard in China's banking sector.¹¹⁰

As Halliday and Paler argue, to implement a market-oriented insolvency system in China, the Communist Party and the government must limit their powers over the operation of insolvency proceedings and strengthen the power and functions of the courts.¹¹¹ As a result, it is important to clarify both the role of administrative authorities before a bank officially declares insolvency and the level of control that courts have over the process of distributing the bank's assets.

5. Conclusion

There are several significant gaps between the law and practice, as well as weaknesses in the current bank insolvency rules. First, the existing rules are primarily designed for non-bank companies and fail to address the unique complexities associated with banks. This lack of specific guidance creates challenges in managing issues such as transferring depositors' accounts and minimising the broader systemic impact of bank failures. Secondly, there is uncertainty regarding the interaction between the BSAL and the EBL, particularly concerning whether administrative reorganisation can effectively replace formal judicial administration. Thirdly, the current policy may permit the repayment of some creditors beyond legal limits before insolvency proceedings begin, leading to unfairness among stakeholders and conflicting with the *pari passu* principle. Fourthly, limited judicial control and strong administrative powers exacerbate the issue, as administrative authorities often make critical decisions before formal proceedings, undermining the effectiveness of judicial oversight.

¹⁰⁹ Yu Wu and Qianqian Zhang, "How has the Financial Market Changed after Baoshang Bank Was Taken Over?", *Xinhua News* (Beijing: 13 July 2019), https://www.gov.cn/xinwen/2019-07/13/content_5409004.htm [Accessed 26 June 2025].

¹¹⁰ Su, "Understanding the Bankruptcy Proceedings of Liaoyang Rural Commercial Bank" (29 August 2022), Tianfeng Securities Research Paper; Financial Stability Board, "Key Attributes of Effective Resolution Regimes for Financial Institutions Revised Version" (2024), Policy Document, p.7.

¹¹¹ Terence C. Halliday, "Lawmaking and Institution Building in Asian Insolvency Reforms: Between Global Norms and National Circumstances" in OECD (eds), *Asian Insolvency Systems: Closing the Implementation Gap* (OECD Publishing, 2007), p.20; Laura Paler, "China's Legislation Law and the Making of a More Orderly and Representative Legislative System" (2005) 182 *The China Quarterly* 301, 318.