

Conceptualising upcoming Chinese bank insolvency law: Cross-border issues

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Abstract

This paper examines the cross-border effectiveness of bank resolution measures in the context of current and soon-to-be revised Chinese bank insolvency legislation, that is, the Bank Resolution Regulation. The general framework is regulated in the Chinese Enterprise Bankruptcy Law. With regard to the outgoing effects of Chinese bank resolution measures, the ultimate decision is in the hands of China's counterparts. However, it is proposed that the contractual approach could be a solution to enhance legal certainty. On the other hand, the incoming effectiveness of foreign resolution measures has to be firstly recognised in China. Three major tests in terms of recognition and enforcement are international agreement, reciprocity, and public policy exception. These criteria should be interpreted against the background of emerging international regime for bank resolution and latest development in the Chinese legal community.

1 | INTRODUCTION

The 2007/2008 financial crisis witnessed the ineffectiveness of traditional corporate insolvency regime for an orderly resolution of financial institutions. World leaders from G20 countries called for the development of “resolution tools and frameworks for the effective resolution of financial groups to help mitigate the disruption of financial institution failures and reduce

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moral hazard in future.”¹ Against this backdrop, administrative authorities (resolution authorities) are empowered to take administrative measures (resolution measures) to orderly resolve ailing financial institutions. Three major paradigm shifts from bank insolvency to bank resolution were identified by Haentjens and Wessels, namely, from individual to public interest, from judicial to government authorities control, and from national regulation to harmonisation and unification.² Public interest is a major concern for resolution authorities to take resolution measures, that is, to avoid systemic risks and maintain financial stability. Apart from the traditional judicial insolvency instruments, such as reorganisation or liquidation, resolution is now an additional insolvency instrument conferring on administrative authorities to take action against banks in distress.

At the international level, efforts have been made to harmonise national resolution laws and to achieve an effective global resolution regime. A detailed proposal was formulated by the Financial Stability Board (FSB) in 2011 as the Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes, or KAs),³ which was later updated in 2014.⁴ Under the new resolution regime, shareholders and creditors are supposed to absorb the losses first instead of using taxpayers' money to bail out banks. Three types of resolution powers were summarized by the International Monetary Fund (IMF):

- (i) assumption of control, that is, to “replace management, clawback remuneration/bonuses” and to “appoint an administrator to take control/manage the firm”;
- (ii) resolution tools, that is, to “transfer assets, liabilities to an existing entity, a bridge bank or an asset management company”; to “bail-in creditors to recapitalize the failed bank or successor”; and to “override stakeholders rights to approve merger, sale, capital injection etc.”;
- (iii) supportive measures, that is, to “suspend payments to unsecured creditors and stay creditor actions”; to “temporarily stay early termination rights”; and to “oblige related group entities to continue to provide essential services and functions.”⁵

In accordance with the FSB resolution reform report as of May 2017,⁶ many jurisdictions, mostly Global Systemically Important Banks (G-SIBs) home jurisdictions,⁷ have implemented

¹G20, “Leaders' Statement The Pittsburgh Summit” (2009).

²Matthias Haentjens and Bob Wessels, “Three Paradigm Shifts in Recent Bank Insolvency Law” (2016) 31 *Journal of International Banking Law and Regulation* 396; Matthias Haentjens and Bob Wessels, “Conclusions” in Matthias Haentjens and Bob Wessels (eds), *Research Handbook on Crisis Management in the Banking Sector* (Edward Elgar, 2015).

³FSB, “Key Attributes of Effective Resolution Regimes for Financial Institutions” (2011).

⁴FSB, “Key Attributes of Effective Resolution Regimes for Financial Institutions” (2014). On October 15, 2014, the FSB adopted additional guidance that elaborates on specific Key Attributes relating to information sharing for resolution purposes and sector-specific guidance that sets out how the Key Attributes should be applied for insurers, financial market infrastructure (FMIs) and the protection of client assets in resolution. No changes were made to the text of the 2011 twelve Key Attributes.

⁵IMF, “The Key Attributes of Effective Resolution Regimes for Financial Institutions—Progress to Date and Next Steps” (2012), 9.

⁶FSB, “Ten Years On—Taking Stock of Post-crisis Resolution Reforms: Sixth Report on the Implementation of Resolution Reforms” (2017).

⁷G-SIB home jurisdictions are Canada, China, France, Germany, Italy, Japan, the Netherlands, Spain, Sweden, Switzerland, the UK and the US. Regarding the 2017 G-SIB list, see FSB, “FSB Publishes 2017 G-SIB List” (21 November 2017), available at: <<http://www.fsb.org/2017/11/fsb-publishes-2017-g-sib-list/>>.

bank resolution regimes broadly in line with the KAs.⁸ Examples are the European legislation the Bank Recovery and Resolution Directive (BRRD)⁹ and the Single Resolution Mechanism Regulation (SRMR),¹⁰ and the U.S. Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank Act).¹¹ Reforms are underway in many other jurisdictions.¹² As a member of the FSB and the home jurisdiction to four G-SIBs,¹³ China is also taking steps to formulate a new Commercial Bank Bankruptcy Risk Resolution Regulation (the Bank Resolution Regulation) as a supplement to the current bank insolvency regime.¹⁴

The cross-border issue is one of the main problems unaddressed in the field of the new bank resolution regime, both in China and across the world.¹⁵ This paper thus intends to examine the cross-border issues in the upcoming Chinese Bank Resolution Regulation. Chinese banks are now actively involved in international businesses. As of end-2015, 22 Chinese banks set up 1,298 outlets in 59 jurisdictions, including 213 subsidiaries, first tier branches, and representative offices.¹⁶ In terms of foreign investors, since the accession to the World Trade Organisation (WTO) and the recent establishment of the Belt and Road Initiative (BRI), China is in an accelerated process of opening up its financial market to foreign investors.¹⁷ It is expected that both cross-border bank operations and failures would increase in China, and the discussion of cross-border bank insolvency and resolution would benefit both China and its counterparties.

⁸Among the FSB jurisdictions, France, Germany, Hong Kong, Italy, the Netherlands, Spain, Switzerland, the UK and the US have implemented the KAs. FSB, “Ten Years On—Taking Stock of Post-Crisis Resolution Reforms” (n 6), 25–26.

⁹Directive 2014/59/EU of the European Parliament and of the Council of May 15, 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, OJ L 173/190.

¹⁰Regulation (EU) No 806/2014 of the European Parliament and of the Council of July 15, 2014, establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, OJ L 225/1.

¹¹Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 12 Stat. 1376 (2010).

¹²These jurisdictions are Argentina, Australia, Brazil, Canada, China, India, Indonesia, Korea, Russia, Saudi Arabia, Singapore, South Africa and Turkey. FSB, “Ten Years On—Taking Stock of Post-Crisis Resolution Reforms” (n 6), 18.

¹³Among the 30 G-SIBs, 4 are Chinese banks, that is, Bank of China (BOC), China Construction Bank (CCB), Industrial and Commercial Bank of China (ICBC), and Agricultural Bank of China (ABC).

¹⁴In accordance with the China Banking Regulatory Commission (CBRC) Announcement on May 9, 2017, the Commercial Bank Bankruptcy Risk Resolution Regulation (商业银行破产风险处置条例) is in the drafting process. See CBRC Office, “Announcement on the 2017 Legislative Plan” (May 9, 2017), available at <<http://www.cbrc.gov.cn/chinese/home/docView/2017D188DE4B4FBABA4EE1F3A3519899.html>>. The CBRC has merged with the China Insurance Regulatory Commission (CIRC) as the new China Banking and Insurance Commission (CBIRC) since March 2018. See “State Council Institutional Reform Plan (国务院机构改革方案)” *The State Council* (March 17, 2018), available at <http://www.gov.cn/guowuyuan/2018-03/17/content_5275116.htm>.

¹⁵FSB (n 6), 1; see also Shuai Guo, “Cross-border Resolution of Financial Institutions: Perspectives from International Insolvency Law,” paper submitted for the International Insolvency Institute Prize 2018, available at <https://www.iiiglobal.org/sites/default/files/media/Submission%20for%20the%20III%20Prize%20in%20International%20Insolvency%20Studies%202018_Shuai%20Guo.pdf>.

¹⁶CBRC 2015 Annual Report, 46.

¹⁷In November 2017, China announced plans to ease limits on foreign ownership of financial services groups. See Gabriel Wildau and Hudson Lockett, “China Pledges to Open Finance Sector to More Foreign Ownership” (*Financial Times*, November 10, 2017), available at <<https://www.ft.com/content/d4a85422-c5d5-11e7-b2bb-322b2cb39656>>.

Section 2 compares the concept of corporate insolvency, bank insolvency, and bank resolution and examines the relevant legislation in China. Section 3 focuses on the cross-border provisions in the Chinese insolvency law as well as relevant legal practices, forming the general framework for the follow-up discussion. Section 4 analyses the outgoing effects of Chinese bank resolution measures and proposes that contractual approaches could be a possible solution for effectuating resolution measures abroad. With this regard, the bail-in tool and temporary stay on early termination powers are addressed. Section 5 discusses the foreign bank resolution measures' effect in China, through the recognition and enforcement mechanism. Attention is paid to the latest development in the Chinese legal community and special features of bank resolution measures. Section 6 draws a conclusion.

2 | CORPORATE INSOLVENCY, BANK INSOLVENCY, AND BANK RESOLUTION IN CHINA

Since the promulgation of the Enterprise Bankruptcy Law (EBL) in 2006,¹⁸ China entered into a new phase of restructuring and liquidating financially difficult enterprises. It is acknowledged that the EBL does “widely comply with accepted international standards and provisions found in modern insolvency codes of other jurisdictions.”¹⁹ In the EBL, three main proceedings are regulated: reorganisation,²⁰ composition,²¹ and liquidation.²² However, with regard to cross-border insolvency issues, only Article 5 provides certain guidance without incorporating the UNICTRAL Model Law on Cross-border Insolvency (UNCITRAL Model Law).²³

Financial institutions that are specifically mentioned in a separate provision in the EBL shall be subject to special treatments.²⁴ First, financial regulatory and supervisory authorities can

¹⁸The Enterprise Bankruptcy Law of the People's Republic of China (中华人民共和国企业破产法) was first promulgated on December 2, 1986, and came into force on November 1, 1988. It was later amended on August 27, 2006, and the revision came into force on June 1, 2007. It is worth noting that the 1986 Law was promulgated during a drastic economic transition period in China and the Law only applied to state-owned enterprises and missed many details under the modern insolvency legal regime. So practically the current insolvency legal framework in China was established by the 2006 Law.

¹⁹Mike Falke, “China's New Law on Enterprise Bankruptcy: A Story with a Happy End?” (2007) 16 *International Insolvency Review* 63. See also recent comments Shaowei Lin, “The Empirical Studies of China's Enterprise Bankruptcy Law: Problems and Improvements” (2018) 27 *International Insolvency Review* 77.

²⁰Chapter 8, Articles 70–94, EBL.

²¹*Ibid.*, Chapter 9, Articles 95–106.

²²*Ibid.*, Chapter 10, Articles 107–124.

²³Qingxiu Bu, “China's Enterprise Bankruptcy Law (EBL 2006): Cross-border Perspectives” (2009) 18 *International Insolvency Review* 187; Guangjian Tu and Xiaolin Li, “The Chinese Approach Toward Cross-Border Bankruptcy Proceedings: One Progressive Step Ahead” (2015) 24 *International Insolvency Review* 57; Rebecca Parry and Nan Gao, “The Future Direction of China's Cross-border Insolvency Laws, Related Issues and Potential Problems” (2018) 27 *International Insolvency Review* 5.

²⁴Article 134, EBL. For the comprehensive introduction of current legal instruments for Chinese bank insolvency, see Qingjiang Kong, *New Bank Insolvency Law for China and Europe Volume 1: China* (Eleven International Publishing, 2017). See also Book Review of the above by Su Jieche and Casey Watters in (2018) 27 *International Insolvency Review* 135.

request the courts to commence the reorganisation and liquidation proceedings.²⁵ This is different from the normal corporate insolvency proceedings where only the debtors or the creditors can make such a request.

Second, additional administrative powers are conferred on these authorities, including assumption of control and trusteeship. In particular, the Commercial Bank Law (CBL)²⁶ and the Regulation of and Supervision over the Bank Industry Law (RSBIL)²⁷ provide special rules on assumption of control. The CBL stipulates that the banking regulatory authority under the State Council, that is, the CBIRC, may assume control over a commercial bank when it has suffered or will possibly suffer, credit crisis, thereby seriously affecting the interests of the depositors.²⁸ The RSBIL also contains similar provisions.²⁹ Assumption of control is classified by the IMF as one of the resolution powers.³⁰ The new Bank Resolution Regulation in the drafting process is expected to be in line with the Key Attributes and to empower the Chinese authorities to take additional resolution powers including resolution tools and supportive measures.

Another important legislation regarding bank insolvency in China is the 2015 Deposit Insurance Regulation (DIR).³¹ This regulation aims to establish the deposit insurance system in China and to protect the interests of depositors as well as to prevent financial risks and maintain financial stability.³² Covered banks are supposed to participate in the deposit insurance scheme which provides for depositors at most RMB 500,000 repayment in case of bank failures.³³ The DIR adopts a territorial approach and only covers Chinese domestic banks and excludes foreign branches of Chinese banks and Chinese branches of foreign banks.³⁴ Under the DIR, only domestic issues are regulated without further indication on cross-border issues.

Bank insolvency and bank resolution should be considered as special rules under the general corporate insolvency law framework. From the perspective of legislation hierarchy, the EBL is a

²⁵Chinese financial regulatory and supervisory authorities were previously called “one bank, three commissions” (一行三会), that is, the central bank—the People's Bank of China (PBOC), the CBRC, the China Securities Regulatory Commission (CSRC) and the CIRC. Regarding these authorities, See H Huang, “Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis” (2010) 10 *Journal of Corporate Law Studies* 219. As explained above (n 14), the new CBIRC has replaced the previous CBRC and CIRC.

²⁶The Commercial Bank Law of the People's Republic of China (《中华人民共和国商业银行法》) was first promulgated on May 10, 1995, and came into force on July 1, 1995. It was later amended on December 27, 2003, and August 29, 2015, and the latest version came into force on October 1, 2015. However, the 2015 version only has two changes compared to that of 2003, one is Item (2), Paragraph 1 of Article 39, that is, “the ratio of the outstanding of loans to the outstanding of deposits may not exceed 75 percent” shall be deleted; and the other is the “ratio of deposits to loans” in the Item (3) of Article 75 shall be deleted. This new amendment is mainly to reduce regulation on the ratio of deposits to loans in order to stimulate banks' businesses. As such, the 2015 Law is not quite different from 2003 Law.

²⁷The Regulation of and Supervision over the Banking Industry Law of the People's Republic of China (《中华人民共和国银行业监督管理法》) was first promulgated on December 27, 2003, and came into effect on February 1, 2004. It was later amended on October 31, 2006 and came into effect on January 1, 2007.

²⁸Article 64, CBL.

²⁹Article 38, RSBIL.

³⁰See above (n 5) and accompanying text.

³¹The Deposit Insurance Regulation (《存款保险条例》) was promulgated on February 17, 2015, and came into effect on May 1, 2015. See Kong (n 24), Chapter 9.

³²Article 1, DIR.

³³*Ibid.*, Article 5.

³⁴*Ibid.*, Article 2.

general law governing all the insolvency cases. The EBL, the CBL, and the RSBIL are laws approved by the Standing Committee of the National People's Congress (NPC), the legislative body in China. The bank insolvency provisions in the CBL and the RSBIL are special rules subject to the EBL. Also, the EBL was formulated after the enactment of the CBL and the RSBIL; thus, the new EBL shall prevail.³⁵ The Bank Resolution Regulation as well as the DIR are regulations formulated by the government and should be subordinated to the laws. The full name of the Bank Resolution Regulations is the Commercial Bank Bankruptcy Risk Resolution Regulation.³⁶ As indicated by the words "Bankruptcy Risk," the Chinese authorities would treat this regulation as a special rule to the general insolvency legal framework.

Given the administrative nature of the new bank resolution regime, attention should be paid with regard to the difference between resolution and other judicial insolvency proceedings. However, the UNCITRAL Model Law clearly states that insolvency proceedings refer to both collective judicial or administrative proceedings.³⁷ Similarly, "court" in UNCITRAL Model Law covers both judicial and other authorities.³⁸ In such sense, the administrative nature of resolution does not exclude resolution from the general scope of insolvency. For instance, the European legislator treats resolution as one type of "reorganisation" measures.³⁹ In addition, a U.S. court also confirmed that the administrative winding-up proceedings can still apply the traditional corporate insolvency law.⁴⁰

In short, the special bank resolution regime would still be subject to the Chinese EBL, including the cross-border provisions embedded in Article 5. The cross-border issues have been a centre topic among the Chinese insolvency lawyers, for both general corporate insolvency and the special bank insolvency.⁴¹ However, the previous research does not take into account the recent development of bank resolution law. Some ambiguity needs to be clarified about those special resolution measures. This paper thus aims to fill the gap and focuses on the cross-border issues in the upcoming Chinese Bank Resolution Regulation. It should be noted that the following discussion does not go beyond the realm of Article 5 of the EBL.

3 | RESTRICTED UNIVERSALISM IN THE CHINESE INSOLVENCY LAW

3.1 | Article 5 of the EBL

Article 5 is the major provision in the EBL that provides the general framework for cross-border insolvency in China. As explained above, this article also governs the future cross-border bank resolution cases. Its two paragraphs address two issues respectively: what is the extraterritorial

³⁵Article 134(2), EBL: the State Council may formulate implementation rules for financial institutions insolvency in accordance with the EBL.

³⁶See above (n 14).

³⁷Article 2(a), UNCITRAL Model Law.

³⁸Ibid., Article 2(e).

³⁹Article 117, BRRD.

⁴⁰*In re* Irish Bank Resolution Corporation Ltd., 538 B.R. 692 (D. Del. 2015), 698.

⁴¹See, particularly, Jingxia Shi, *Studies on Legal Issues in Cross-border Insolvency* [跨国破产的法律问题研究] (Wuhan University Press, 1999); A. Li, *Study on Legal Issues of Cross-border Insolvency of Commercial Banks* [商业银行跨境破产法律问题研究] (China University of Political Science and Law Press, 2012).

effect of Chinese insolvency proceedings and what is the legal effect of foreign insolvency proceedings in China:

Once the procedure for bankruptcy is initiated according to this Law, it shall come into effect in respect of the debtor's property outside of the territory of the People's Republic of China.

Where a legally effective judgment or ruling made on a bankruptcy case by a court of another country involves a debtor's property within the territory of the People's Republic of China and the said court applies with or requests the people's court to recognise and enforce it, the people's court shall, according to the relevant international treaties that China has concluded or acceded to or on the basis of the principle of reciprocity, conduct examination thereof and, when believing that the said judgment or ruling does not violate the basic principles of the laws of the People's Republic of China, does not jeopardise the sovereignty and security of the State or public interests, does not undermine the legitimate rights and interests of the creditors within the territory of the People's Republic of China, decide to recognise and enforce the judgement or ruling.⁴²

Regarding the scope of effects of one jurisdiction's insolvency proceedings, there are two competing principles: universalism and territorialism. The former refers to the worldwide effect of an insolvency proceeding, and the latter means that the effect of an insolvency proceeding is limited to the territory of the jurisdiction where the insolvency proceeding is commenced.⁴³ A distinction is made regarding the outgoing effect and incoming effect, addressing the overseas effects of domestic proceedings and domestic effects of foreign proceedings respectively.⁴⁴ Article 5 reflects both outgoing universalism and incoming universalism.

On the one hand, regarding the outgoing effect of Chinese domestic insolvency proceedings, China holds the position that the assets located outside China are still under the control of domestic insolvency proceedings.⁴⁵ However, the actual implementation of Chinese insolvency proceedings would depend on the counterpart's attitudes.

On the other hand, China also allows foreign insolvency proceedings to be effective in China but with strict conditions. This approach is referred to in this paper as restricted universalism.⁴⁶

⁴²Article 5, EBL.

⁴³Regarding universalism and territorialism, see, for example, Bob Wessels, *International Insolvency Law Part I: Global Perspectives on Cross-Border Insolvency Law* (4th edn; Kluwer, 2015), paragraph 10009 ff; Gabriel Moss QC, Bob Wessels and Matthias Haentjens, "Principles for Cross-border Financial Institution Insolvencies" in Gabriel Moss QC, Bob Wessels and Matthias Haentjens (eds), *EU Banking and Insurance Insolvency* (OUP, 2017), paragraph 2.03 ff.

⁴⁴Bork distinguishes the difference between outgoing universalism and incoming universalism: the former refers to the practice that "the insolvency proceedings opened by its official bodies are exclusive and have worldwide effect"; while the latter means "a state accepts the effects of foreign proceedings on its own territory." See Reinhard Bork, *Principles of Cross-border Insolvency Law* (Intersentia, 2017), 26–27.

⁴⁵The outgoing universalism approach is widely accepted among the scholar. See Bu (n 23); Emily Lee and Karen Ho, "China's New Enterprise Bankruptcy Law—A Great Leap Forward, but Just How Far?" (2010) 19 *International Insolvency Review* 145; Parry (n 23).

⁴⁶See Li (n 41), 311. Some would refer to this approach as territorialism. See Tu (n 23), 58. However, it is pointed out in this paper that China does not prohibit the effectiveness of foreign insolvency proceedings, but only puts restrictions on recognising such effectiveness. Thus, it is not appropriate to treat this as a territorialism approach. Parry and Gao considered this as a modified universalism approach. See Parry and Gao (n 23), 12.

In accordance with this article, the premises for recognition and enforcement is either international agreements or reciprocity. Only when one of the two conditions is met can a foreign insolvency proceeding be recognised. However, there is an additional safeguard mechanism, that is, public policy exception, which could be the basis for denial of recognition and enforcement. The public policy exception consists of two circumstances: one is that the foreign proceedings violate the basic principles of the laws of China, or jeopardise the sovereignty and security of the State or public interest, and the other one is that the proceedings undermine the legitimate rights and interests of the creditors within China.

It is also noted that this provision does not prescribe jurisdiction issues. However, article 3 of the EBL stipulates that the People's Court of the place where the debtor is domiciled shall have jurisdiction over the case.⁴⁷ This provision is targeted at the jurisdiction issue of Chinese domestic insolvency cases.⁴⁸ But it could be inferred that when a debtor's domicile is located in another jurisdiction, an insolvency proceeding against this debtor should be commenced in the foreign jurisdiction.⁴⁹ In accordance with the General Rules on the Civil Law of the People's Republic of China (GRCL),⁵⁰ a legal person's domicile is its main office location.⁵¹ China has not adopted the UNCITRAL Model Law and it is assumed that China only allows one insolvency proceeding where the debtor's domicile is located.⁵²

3.2 | Cross-border insolvency cases

This section describes several cases to illustrate China's attitude towards cross-border insolvency cases. There are two cross-border bank insolvency cases in China that worth mentioning. One is the insolvency of the Bank of Credit and Commerce International (BCCI), and the other one is the insolvency of the Lehman Brothers.

The BCCI Group collapsed in 1991, and provisional liquidation proceedings were commenced in Luxembourg and England in July 1991 and in the Cayman Islands at about the same time.⁵³ In the meanwhile, the Bank of China Shenzhen Branch initiated an insolvency proceeding against the BCCI Shenzhen Branch in Shenzhen Intermediate People's Court. The court ruled that foreign insolvency proceedings do not have binding effect in China and continued to rule that domestic assets, in total USD 20 million, should be distributed among domestic creditors.⁵⁴ This is a case before the enactment of the EBL, and it indicates a strong territorial approach. But because it was a long time ago, it cannot fully represent the attitudes of Chinese courts nowadays.

⁴⁷Article 3, EBL.

⁴⁸Li (n 41), 310–311.

⁴⁹See Bu (n 23), 202–203. Li questions the applicability of Article 3 on cross-border cases. See Li (n 41), 311.

⁵⁰The General Rules on the Civil Law of the People's Republic of China (中华人民共和国民法总则) was promulgated on March 15, 2017, and came into effect on October 1, 2017.

⁵¹Article 63, GRCL.

⁵²It is proposed though by scholars that the UNCITRAL Model Law should be incorporated into the Chinese law. See Jingxia Shi, "Chinese Cross-border Insolvencies: Current Issues and Future Developments" (2001) 10 *International Insolvency Review* 33; Bu (n 23); Lee and Ho (n 45).

⁵³See Sandy Shandro, "Judicial Co-operation in Cross-border Insolvency—The English Court Takes a Step Backwards in BCCI (No. 10)" (1998) 7 *International Insolvency Review* 63.

⁵⁴Due to the restricted access and limited online resources, the original judgment cannot be found. However, Chinese scholars have described this case, see, for example, Shi (n 52), 39–40.

A more recent case was *Hua An Funds v. Lehman Brothers International Europe (LBIE)* in 2008.⁵⁵ Hua An International Balanced Funds was launched in 2006 under China's Qualified Domestic Institutional Investor (QDII) scheme by Hua An Funds Management Co. and invested in structured notes designed by the Lehman Brothers. Hua An brought the Lehman Brothers to the Shanghai High People's court in September 2008 after Lehman's collapse. After 3 years, in 2011, Lehman Brothers agreed to pay Hua An USD 44.89 million in compensation. The legal challenge was, at that time, Lehman Brothers had already initiated insolvency proceedings in the United Kingdom, and the Lehman Brothers claimed that Hua An Fund should participate in the global insolvency proceedings and the court cannot take action. However, the court decided that the insolvency proceedings in the United Kingdom cannot be recognised in China due to two considerations. One is that there is no international agreement between the United Kingdom and China that involves international insolvency issues; the other one is there was no precedent that the United Kingdom had recognised China's insolvency proceedings thus there was no legal basis for reciprocity.⁵⁶ It can be drawn from this case that, even in 2011, China still had a strong intention to protect the assets of its own citizens and enterprises. And if there is no agreement or precedent of recognition of Chinese judgments in another jurisdiction, it is unlikely that a Chinese court would recognise bank insolvency proceedings from that jurisdiction.

However, the above two cases do not demonstrate that China would not recognise foreign insolvency proceedings. Conversely, as early as 2000 in the B&T case in Foshan, Guangdong Province, a Chinese court had recognised foreign insolvency proceedings for the first time.⁵⁷ In this case, Foshan Intermediate People's Court decided to recognise an Italian insolvency proceeding because there is a treaty on judicial assistance in civil matters between the People's Republic of China and the Republic of Italy.⁵⁸ Finally, the Italian company obtained its 98% shares in Nanhai Nasseti Pioneer Ceramic Machinery Co. Ltd of USD 5.39 million.

Another case indirectly involving cross-border insolvency is the *Sino-Environment Technology Group Limited, Singapore v Thumb Env-Tech Group (Fujian) Co., Ltd* case.⁵⁹ This is a dispute mainly regarding shareholder capital contribution. The Singapore company was the shareholder of the Chinese Fujian Company, and it did not fulfil the capital contribution obligation and was brought to the court by the Chinese company. During the trial, the Singapore company went into administration, one type of insolvency proceedings in Singapore, and the issue was raised whether the administrator appointed by the Singapore court can act as the representative of the Singapore company in China. Instead of addressing the recognition issue, the Supreme Court invoked Article 14 of the Law on Application of Law for Foreign Related Civil Relationships of the People's

⁵⁵[2008] Hu Gao Min Si (Shang) Chu Zi No.6 Conciliation Statement. The document is confidential.

⁵⁶Since the Conciliation Statement is confidential, the opinion stated here is a reflection of a judge from the Shanghai High People's Court, who heard the Lehman Brothers case. See Fengxiang Zhang, "The Needs for Improvement of Relevant Laws Arising from the Financial Derivative Products Cooperative Disputes between Hua An Funds and Lehman Brothers International Europe" (2012), available at: <<http://old.ccmt.org.cn/showexplore.php?id=4148>>. See also Xinyi Gong, "To Recognise or Not to Recognise? Comparative Study of Lehman Brothers Cases in Mainland China and Taiwan" (2013) 10 *International Corporate Rescue* 240.

⁵⁷(2000) Fo Zhong Fa Jing Chu Zi No.663 Civil Decisions. However, the original document cannot be found online.

⁵⁸For more information about the case, see Jianhong Liu, "A Case on Application for Recognition and Enforcement of Italian Court Ruling on Bankruptcy" (2003) *China Law* 32. The author is a judge at Foshan Intermediate People's Court.

⁵⁹(2014) Min Si Zhong Zi No 20 Civil Ruling. See also comments Tu (n 23).

Republic of China (LAL)⁶⁰ and decided that the civil rights and capacity of the administrator and liquidator should be governed by the law of the place where the debtor is registered.

As can be seen from the cases, in terms of incoming recognition and enforcement, Chinese courts follow the restricted conditions specified in Article 5 to examine the request of foreign representatives. If there is no treaty exists, and there is no legal basis for reciprocity, it is unlikely that a Chinese court will recognise or enforce a foreign insolvency proceeding. However, a foreign administrator, without touching upon the recognition and enforcement issue, may act as the representative of the foreign debtor and exercise the power in China accordingly.

4 | OUTGOING EFFECTS OF CHINESE BANK RESOLUTION MEASURES

4.1 | Possible responses from other jurisdictions

China takes the outgoing universalism approach with regard to its insolvency proceedings' effects abroad. However, as a matter of fact, the ultimate decision power is in the hands of the counterpart jurisdictions, despite that the Chinese authorities would like to extend their powers to the Chinese debtor's foreign assets. With regard to bank resolution measures, the counterparties may be more cautious because public interest is involved in the resolution cases.

For example, in the EU, one of the largest Chinese counterparts, the BRRD was enacted and has been transposed into national laws.⁶¹ Title VI of the BRRD regulates "relations with third countries," and the Union branch is subject to the foreign jurisdiction, unless "a Union branch is not subject to any third-country resolution proceedings or that is subject to third-country proceedings and one of the circumstances referred to in Article 95 applies." Article 95 lists five circumstances where the EU resolution authorities can refuse to recognise or enforce third-country resolution proceedings. These circumstances are generally categorised as public policy exceptions, including the following:

- (a) that the third-country resolution proceedings would have adverse effects on financial stability in the Member State in which the resolution authority is based or that the proceedings would have adverse effects on financial stability in another Member State;
- (b) that independent resolution action under Article 96 in relation to a Union branch is necessary to achieve one or more of the resolution objectives;
- (c) that creditors, including in particular depositors located or payable in a Member State, would not receive the same treatment as third-country creditors and depositors with similar legal rights under the third-country home resolution proceedings;
- (d) that recognition or enforcement of the third-country resolution proceedings would have material fiscal implications for the Member State; or
- (e) that the effects of such recognition or enforcement would be contrary to the national law.⁶²

⁶⁰The Law on Application of Law for Foreign Related Civil Relationships of the People's Republic of China was promulgated on October 28, 2010, and came into effect on April 1, 2011. Article 14 stipulates that the internal affairs of a legal person and its branch such as legal rights, legal capacity, internal organisations, rights and obligations of shareholders shall be governed by the law of the place where such an entity is registered.

⁶¹Article 130, BRRD Transposition.

⁶²Article 95, BRRD.

Based on this provision, the EU authorities may refuse to recognise and enforce Chinese resolution measures due to the consideration of these circumstances even if Chinese authorities determine that the resolution measures should have worldwide effect. In other words, as long as national authorities can take a unilateral discretionary decision on whether or not to recognise foreign resolution measures, there must be legal uncertainty regarding effectuating bank resolution measures abroad.

4.2 | Contractual approaches

Unless an international agreement has entered into effect or a similar statutory regime is in place, the outgoing effects of Chinese bank resolution measures would be in great doubt. A possible solution to help achieve the goal of the cross-border effectiveness of resolution actions is to apply the contractual approach, requiring the Chinese financial institutions to add a contractual recognition clause in the financial instruments creating liabilities for those institutions. As required by the FSB, authorities should require, or provide incentives for, firms to adopt contractual approaches.⁶³ Although concerns have been expressed by various institutions about the enforceability issues such as lack of support from statutory law and possible inconsistency with public policy,⁶⁴ contractual approaches can be a possible interim solution for the effectiveness of cross-border resolution actions. It is acknowledged by Schwarcz et al. that “[c]ontractual approaches cannot fill the gap [where no statutory recognition framework is in place], but to a limited extent they can help to reinforce legal certainty and predictability absent a statutory framework.”⁶⁵ The following two sections specifically illustrate two examples: contractual bail-in and contractual temporary stay, which were proposed by the FSB⁶⁶ and has been applied in several model contracts.

4.2.1 | Contractual bail-in

The bail-in tool is to write down equity or other instruments of ownership, unsecured and uninsured creditor claims; to convert all or parts of unsecured and uninsured creditor claims into equity or other instruments of ownership.⁶⁷ Bail-in is a restructuring process, which requires the shareholders and creditors to absorb the losses first, thus reducing the possibility of using taxpayers' money to bail out large banks.⁶⁸ The statutory bail-in tool has been incorporated into the national legislation, such as the BRRD.⁶⁹

⁶³FSB, “Principles for Cross-border Effectiveness of Resolution Actions” (November 3, 2015).

⁶⁴Public responses can be viewed on the FSB website. See FSB, “Public responses to the September 2015 consultative document ‘Cross-border Recognition of Resolution Actions’” (December 12, 2014), available at: <<http://www.fsb.org/2014/12/public-responses-to-the-september-2014-consultative-document-cross-border-recognition-of-resolution-actions/>>.

⁶⁵Steven Schwarcz et al., “Comments on the September 29, 2014 FSB Consultative Document, ‘Cross-Border Recognition of Resolution Action’” (2014) Centre for International Governance Innovation CIGI Paper No 51.

⁶⁶FSB (n 63), 7–8.

⁶⁷KA 3.5.

⁶⁸See, for example, Emiliios Avgouleas and Charles Goodhart, “Critical Reflections on Bank Bail-ins” (2015) 1 *Journal of Financial Regulation* 3; Karl-Philipp Wojcik, “Bail-in in the Banking Union” (2016) 53 *Common Market Law Review* 9.

⁶⁹Articles 43–58, BRRD. In the BRRD, bail-in only refers to write down or convert creditors' claims.

The contractual bail-in, as provided in Article 55 of the BRRD, has been implemented in the EU starting from January 1, 2016.⁷⁰ Institutions in the EU are required to include a contractual term in certain agreements that creditors agree to be bound by the bail-in tool initiated by the European resolution authorities; these agreements are those creating liabilities for European institutions but governed by the law of a third country other than the EU Member States.⁷¹ Despite there is a possibility that the foreign supervisor may forbid this kind of contract term,⁷² the contractual approach can somehow provide a certain guarantee when the foreign law does not have explicit provisions over this issue. The International Swaps and Derivative Association (ISDA) published the Bail-in Article 55 BRRD Protocol,⁷³ functioning as a guide for international derivative traders to incorporate the contractual bail-in provision.

On the Chinese bond market there is a similar instrument, the so-called “write-down Tier 2 capital instruments.”⁷⁴ As required by the contractual terms, creditors who purchase the bonds should agree to be bound by the write-down or conversion measures taken by the authorities. The first of this kind of bond was issued by Tianjin Bin Hai Nong Shang Bank on July 25, 2013.⁷⁵ The actual purpose of issuing such bond is to meet the capital requirements. In response to the financial crisis, the Basel Committee on Banking Supervision (BCBS) introduced new global banking supervision standards, the Basel III.⁷⁶ Accordingly, in order to comply with the Basel standard, China further issued the Measures for the Management of Capitals of Commercial Banks (Provisional; the Capital Rules)⁷⁷ and requires the banks to hold sufficient funds. The issuance of these capital instruments bonds facilitates the accumulation of capitals. It should be noted that these Chinese T2 instruments differ from those complied with Article 55 of the BRRD. First, only capital instruments are subject to write-down and conversion in China, but the EU bail-in is applied to other subordinated or senior debts. Second, the T2 capital instruments are governed by the Chinese law whereas the contractual bail-in approach in BRRD is

⁷⁰Article 130, BRRD Transposition.

⁷¹Article 55, BRRD.

⁷²See Commission, Commission Staff Working Document Impact Assessment Accompanying the document Proposal amending: Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms; Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms; Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms; Regulation (EU) No 806/2014 of the European Parliament and of the Council of July 15, 2014, establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund, SWD/2016/0377 final/2–2016/0360 (COD).

⁷³ISDA 2016 Bail-in Article 55 BRRD Protocol (Dutch/French/German/Irish/Italian/Luxembourg/Spanish/UK entity-in-resolution version). A second version was updated in 2017. ISDA, “ISDA Publishes Second Bail-in Article 55 BRRD Protocol” (April 19, 2017), available at <<https://www.isda.org/a/dpDDE/article-55-protocol-2-press-release-final.pdf>> .

⁷⁴See the China Bond website at <<http://www.chinabond.com.cn/>>. “Write-down Tier 2 capital instruments” can be viewed by selecting bond type “Tier 2 capital instruments.”

⁷⁵More information is available on the China Bond website at <<http://www.chinabond.com.cn/jsp/include/EJB/queryResult.jsp?queryType=0&sType=2&zqdm=&zqjc=&zqzx=34&eYear2=0000>>.

⁷⁶BCBS, “Basel III: A Global Regulatory Framework for more Resilient Banks and Banking Systems” (rev June 2011); BCBS, “Liquidity Coverage Ratio” (January 2013); BCBS, “Net Stable Funding Ratio” (October 2014); BCBS, “Basel III: Finalising Post-crisis Reforms” (December 2017).

⁷⁷The Measures for the Management of Capitals of Commercial Banks (商业银行资本管理办法(试行)) was promulgated on June 7, 2012, and came into effect on January 1, 2013. In accordance with this regulation, the total amount of the capital of a commercial bank consists of Common Equity Tier 1 (CET1) capital, Additional Tier 1 (AT1) capital and Tier 2 (T2) capital.

supposed to ensure the effectiveness of foreign-law governed contracts. In such sense, China actually does not have a contractual bail-in tool. However, because the contractual term might be similar, it is feasible and realisable to propose that such contractual approach should be incorporated into the upcoming Chinese Bank Resolution Regulation in terms of foreign law governed instruments, with the aim to enhance the overseas effectiveness of Chinese bail-in measures.

4.2.2 | Contractual temporary stay on early termination rights

Early termination rights, such as the close-out netting,⁷⁸ is a commonly used tool to protect the creditors when the debtors enter into insolvency. However, the latest crisis witnessed the disruptive effects of exercising these early termination rights, and thus, the FSB recommends that the resolution authorities should be able to temporarily stay these early termination rights to maintain the continuity of the critical functions of the financial institutions in distress.⁷⁹

In the absence of an appropriate statutory framework for recognition, it is likely that a domestic court would not recognise a temporary stay on the domestic law-governed contract exercised by the foreign authorities. Thus, a contractual term recognising such powers of foreign authorities would enhance the foreign effectiveness of temporary stay on early termination rights. The ISDA has also published the ISDA 2015 Universal Resolution Stay Protocol⁸⁰ as a guide for incorporating contractual temporary stay terms, similar to the Bail-in Protocol. According to the FSB report, all the G-SIBs except for Chinese ones have adopted the ISDA 2015 Universal Protocol.⁸¹

Concerns may arise with regard to the attitude towards early termination rights and temporary stay in China. Fortunately, it has already been confirmed by the CBRC that close out netting is legitimate in China, and the CBRC is in the project studying the possibility of conducting contractual temporary stay in the upcoming bank resolution regime.⁸² Though the actual implementation plan is still unclear, it is expected that contractual temporary stay on early termination rights would be in existence in the upcoming Chinese Bank Resolution Regulation.

⁷⁸Close-out netting is the cancellation of a series of open executory contracts between parties, for example, for a sale of goods or foreign exchange or investments, on the default of the counterparty and set-off of the resulting gains and losses. Close-out netting requires two steps on a counterparty default: cancellation of the unperformed contracts, and then set-off the gains and losses on each contract, so as to produce a single net balance owing one way or the other. See Philip Wood, *Law and Practice of International Finance* (Sweet & Maxwell, 2008), paragraph 14–04.

⁷⁹KA 4.3. See Francisco Garcimartín and Maria Isabel Saez, “Set-off, Netting and Close-out Netting” in Haentjens and Wessels (eds) (n 2). KA 4.3 also specifies that a temporary stay should “be strictly limited in time (for example, for a period not exceeding 2 business days)”; should “be subject to adequate safeguards that protect the integrity of financial contracts and provide certainty to counterparties”; and should “not affect the exercise of early termination rights of a counterparty that are not related to entry into resolution or the exercise of the relevant resolution power (for example, failure to make a payment, or deliver or return collateral on a due date) occurring before, during or after the period of the stay.”

⁸⁰ISDA, “ISDA 2015 Universal Resolution Stay Protocol” (November 4, 2015).

⁸¹FSB (n 6), 13.

⁸²CBRC, Responses to the Fifth Meeting of the Twelfth NPC Recommendation No 2691 [对十二届全国人大五次会议第2691号建议答复的函], Yin Jian Shen Han [2017] No 105.

5 | INCOMING EFFECTS OF FOREIGN BANK RESOLUTION MEASURES IN CHINA

In contrast with the previous section, this section focuses on the effectiveness of foreign bank resolution measures in China. Because Article 5 of the EBL only discusses the recognition and enforcement issue, this section also only examines the conditions for recognition and enforcement: international agreement, reciprocity, and public policy exception.

5.1 | International agreement

It is possible that a Chinese authority would recognise the foreign bank resolution measures' effects in China in accordance with international agreements. In addition to the traditional judicial assistance treaty, in the banking sector, there are many other forms of agreements, such as institution-specific cross-border cooperation agreements (CoAgs), Memorandum of Understandings (MOUs), and protocol.

The CoAgs was proposed in the FSB Key Attributes as a coping mechanism specifically targeted at Global Systemically Important Financial Institutions (G-SIFIs).⁸³ In these agreements, the roles and responsibilities of the authorities should be defined, and home and host authorities' commitments with regard to cooperation shall also be specified.⁸⁴ As of end-2015, the CoAgs were drafted for ICBC, ABC, and BOC in China, except for CCB.⁸⁵

MOU is another common agreement signed between the home and host authorities regarding banking sector supervision cooperation. An example is the MOU reached by the Federal Deposit Insurance Corporation (FDIC) and Bank of England (BOE) on resolution issues.⁸⁶ The CBRC has been actively involved in the international cooperation, and as of July 2017, the CBRC has entered into similar agreements with authorities in 68 foreign jurisdictions.⁸⁷ Despite that these agreements do not cover resolution matters, they could possibly provide the legal basis for further and future cooperation between Chinese and foreign authorities.

The protocol instrument was used in the Lehman Brothers insolvency proceedings, as the "Cross-border Insolvency Protocol for the Lehman Brothers Group of Companies" (The Lehman Protocol).⁸⁸ China, however, was not a party to the Lehman Brothers Protocol, but it does not rule out the possibility that China would become a party to such kind of protocols in the future. It should be noted that the above mentioned international agreements are not binding in nature.⁸⁹ However, it is possible that they could serve as the legal basis for recognising and

⁸³KA 9.

⁸⁴Key Attributes Appendix I-annex 2: Essential Elements of Institution-specific Cross-border Cooperation Agreements.

⁸⁵CBRC 2015 Annual Report, 125.

⁸⁶Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information Related to the Resolution of Insured Depository Institutions with Cross-border Operations in the United Kingdom and the United States, January 10, 2010. Also, see the MOU reached by the FDIC and the BOE titled Resolving Globally Active, Systemically Important, Financial Institutions (2012).

⁸⁷CBRC, "List of Memorandum of Understandings on Bilateral Supervision Cooperation and Statement of Supervision Cooperation signed by the CBRC" (September 19, 2017), available at <<http://www.cbrc.gov.cn/chinese/home/docView/71441D9239DD49CAB801DBACDC74A258.html>>.

⁸⁸See the execution copy, available at:<<https://www.insol.org/Fellowship%202010/Session%209/Lehman%20protocol%20executed.pdf>>.

⁸⁹KA 9; Article 2, FDIC-BOE MOU 2010, paragraph 5; Term 1.2, Lehman Protocol. See Guo (n 15), 25–26.

enforcing foreign resolution measures, given that the Chinese authorities may still choose to accept their effectiveness.

5.2 | Reciprocity

In China, reciprocity is still a mandatory requirement for recognition and enforcement except for the circumstances of existing international agreements.⁹⁰ China even imposes a “real reciprocity” requirement,⁹¹ that is, a foreign jurisdiction has to recognise and enforce a Chinese judgment before, then subsequently it is possible that a Chinese court would recognise and enforce a judgment from that jurisdiction.

In spite of being prescribed in the laws, the reciprocity principle was seldom invoked by the courts. The recent judgment made by the Nanjing Intermediate People's Court in 2016,⁹² which recognised a Singapore commercial judgment, was claimed to be the first case in which a Chinese court recognised a foreign court judgment based on the principle of reciprocity in the absence of a treaty.⁹³ In this contract dispute case, KolmarGroupAG submitted its request to the Nanjing Intermediate People's Court for recognising judgments made by the Singapore High Court on October 22, 2015. There is indeed a treaty between China and Singapore on judicial assistance in civil and commercial matters; however, mutual recognition of judicial judgments is not covered in the scope of this treaty. But the judge on this case continued to rule that the Singapore judgment can be recognised in China because there was a precedent of Singapore court recognising Chinese judgments before; thus, the ruling for recognition is based on the reciprocity principle, with the consideration that no public interest or national laws are violated.

In addition, the current development in the Chinese legal community has to be taken into account as well, in particular, the Belt and Road Initiative (BRI). The BRI, also known as the One Belt One Road (OBOD) Initiative when first proposed in 2013, originates from the ancient Silk Road trading routes throughout Eurasia and aims to boost the global economy.⁹⁴ Alongside the initiative, the Supreme People's Court of the People's Republic of China (SPC) published eight guiding cases on July 7, 2015⁹⁵ and 10 guiding cases on May 15, 2017⁹⁶ regarding the BRI, respectively. These cases include *Przedsiębiorstwo Przemysłu Chłodniczego Fritar S.A.*,

⁹⁰Article 5, EBL. The Civil Procedure Law of the People's Republic of China (CPL) also contains the same requirement. See Articles 281–283, CPL.

⁹¹Wenliang Zhang, “Recognition and Enforcement of Foreign Judgments in China: A Call for Special Attention to Both the ‘Due Service Requirement’ and the ‘Principle of Reciprocity’” (2013) 12 *Chinese Journal of International Law* 143.

⁹²(2016) Su 01 Xie Wai Ren No 3 Civil Ruling.

⁹³Baker McKenzie, “First Time PRC Court Recognizes a Foreign Judgment Based on Principle of Reciprocity” (7 February 2017), available at <<https://www.bakermckenzie.com/en/insight/publications/2017/01/first-time-prc-court-recognizes-a-foreign>>.

⁹⁴For a more detail introduction of the BRI, please see the BRI official website at <<http://english.gov.cn/beltAndRoad/>>.

⁹⁵SPC, “Typical Cases of the People's Court for Providing Judicial Services and Guarantee for the Belt and Road Initiative” (July 7, 2017), available at <<http://www.court.gov.cn/zixun-xiangqing-14897.html>>.

⁹⁶SPC, “Typical Cases for the Belt and Road Initiative II” (May 15, 2017), available at <<http://www.court.gov.cn/zixun-xiangqing-44722.html>>.

Poland,⁹⁷ a case on recognition of foreign judgment, and the above-mentioned *Sino-Environment Technology Group Limited, Singapore v Thumb Env-Tech Group (Fujian) Co., Ltd.*, and *KolmarGroupAG* case. The publication of these guiding cases reflects that Chinese courts are more willing to deal with cross-border disputes, be bound by international obligations, respect foreign legal systems and treat foreign parties on an equal basis.⁹⁸

In addition, the Supreme Court has emphasized in the Opinions of Providing Judicial Service and Guarantee for Belt and Road Initiative⁹⁹ that the courts may also consider to give judicial assistance first to other parties in the foreign jurisdictions and expand the scope of international judicial assistance. This indicates the possibility that a Chinese court may recognise foreign insolvency proceedings without requiring that the other jurisdiction has recognised a Chinese judgment or ruling before.

5.3 | Public policy exception

There is an additional safeguard mechanism with the purpose to protect the local interests of China, namely, public policy exception. In the Chinese EBL, public policy is more extensively stated as “the basic principles of the PRC laws, the State sovereignty, security or public interest” and “the legitimate rights and interests of the creditors.”¹⁰⁰ This is a broad definition of public policy and can be effectively invoked as an excuse to refuse the recognition and enforcement. However, public policy exception has not been used in cross-border insolvency cases in China. In fact, the public policy has not been invoked even in cases requesting recognition of other civil and commercial matters.¹⁰¹

For one reason, there are strict premises of previous mentioned international agreement and reciprocity principle; thus, public policy exception is seldom needed. For another, public policy exception should be restrictedly applied. In the Guide to Enactment and Interpretation of the UNCITRAL Model Law on Cross-border Insolvency, it is provided that public policy exceptions “should be interpreted restrictively and ... is only intended to be invoked under exceptional circumstances concerning matters of fundamental importance for the enacting State.”¹⁰² As can be seen from the choice of words here, public policy exception is narrowly interpreted, with the

⁹⁷(2013) Zhe Yong Min Que Zi No 1 Civil Ruling. This is a dispute between a Polish company and a Chinese company. It is confirmed by the Ningbo Intermediate People's Court that China and Poland have entered into an Agreement on Judicial Assistance in Civil and Criminal Matters, and thus the court grants the recognition request on the basis of such agreement.

⁹⁸Shuai Guo, “Reflections on the Chinese ‘Belt and Road’ Initiative” (*Leiden Law Blog*, May 19, 2017), available at: <<http://leidenlawblog.nl/articles/reflections-on-the-chinese-belt-and-road-initiative>>.

⁹⁹Several Opinions of the Supreme People's Court on the People's Courts Providing Judicial Service and Guarantee for Belt and Road Initiative, Fa Fa [2015] No.9.

¹⁰⁰Article 5, EBL.

¹⁰¹See the article in March 2018, Li Liu, “The Reason and Rule for Recognition and Enforcement of Court Judgments among the “One Belt and One Road” Countries “[一带一路]国家间法院判决承认与执行的理据与规则]” (2018) *Journal of Law Application* 40.

¹⁰²See UNCITRAL, “Guide to Enactment and Interpretation of the UNCITRAL Model Law on Cross-Border Insolvency” (2013), paragraph 104.

requirement of manifestly contrary to the most fundamental policies.¹⁰³ Similarly, the U.S. committee on the judiciary house of representatives also pointed out that public policy exception “has been narrowly interpreted on a consistent basis in courts around the world.”¹⁰⁴ With regard to Chinese opinion, the lack of judicial practices is not helpful in identifying the courts’ attitudes. However, the Chinese academic community seems to consistently confirm the narrow application of the public policy exception and expects the courts to follow this approach in the future cases.¹⁰⁵

The possibility cannot be ruled out for Chinese authorities to invoke public policy to deny recognition and enforcement in terms of cross-border bank resolution. Special attention is paid to two specific public policies: financial stability and protection of creditors’ interest, which have also been specifically listed by the FSB as two reasons to refuse recognition and enforcement.¹⁰⁶

Financial stability has been widely accepted as one of the major public policies.¹⁰⁷ It is also acknowledged that the adoption of bank resolution is to maintain financial stability.¹⁰⁸ Thus, if a foreign resolution measure poses a danger to the local financial stability, it would be against the ultimate goal of the bank resolution mechanism. Under such circumstances, financial stability should be one of the public policy goals and can be invoked to refuse to recognise and enforce foreign resolution measures.

Creditors’ protection is a traditional topic in the insolvency law. In the cross-border context, special attention is paid to the equal treatment of foreign and domestic creditors. In the liquidation process, there is the *pari passu* principle, which guarantees that the debtor’s assets shall be distributed *pro rata* to the creditors in the similar situations.¹⁰⁹ Exceptions are allowed in

¹⁰³Similar way of interpretation is confirmed in academic works, see, for example, Scott Mund, “11 USC 1506: US Courts Keep a Tight Rein on the Public Policy Exception, but the Potential to Undermine Internationals Cooperation in Insolvency Proceedings Remains” (2010) 28 *Wisconsin International Law Journal* 325; Michael Garza, “When Is Cross-Border Insolvency Recognition Manifestly Contrary to Public Policy?” (2015) 38 *Fordham International Law Journal* 1587.

¹⁰⁴H-R Rep. N. 109–31 (2005), 109.

¹⁰⁵See, for example, X. Gao, *On the Application of Public Policy in Private International Law* [论国际私法上的公共政策之运用] (University of International Business and Economics, 2005); D. Ma, *A Study of the Ordre Public in Private International Law* [国际私法中的公共秩序研究] (Wuhan University, 2010); Dan Ye, *On the Public Policy in Chinese Foreign Judicial Practice Relating to Civil and Commercial Matters* (Law Press, 2012).

¹⁰⁶FSB (n 63), 11.

¹⁰⁷See, for example, Andrew Crockett, “Why is Financial Stability a Goal of Public Policy?” (1997) 82 *Economic Review* 5; Charles Wyplosz, “International Financial Stability” in Inge Kaul, Isabelle Grunberg and Marc Stern (eds), *Global Public Goods: International Cooperation in the 21st Century* (OUP, 1999); Michael Patra, “Should Financial Stability Be Assigned to Public Policy?” (2003) 38 *Economic and Political Weekly* 2271.

¹⁰⁸See, for example, Martin Čihák and Erlend Nier, *The Need for Special Resolution Regimes for Financial Institutions: The Case of the European Union* (IMF Working Paper WP/09/200) (International Monetary Fund, 2009); Sven Schelo, *Bank Recovery and Resolution* (Kluwer Law International, 2015); Michael Schillig, *Resolution and Insolvency of Banks and Financial Institutions* (OUP, 2016); Simon Gleeson and Randall Guynn, *Bank Resolution and Crisis Management: Law and Practice* (OUP, 2016).

¹⁰⁹According to the World Bank, following distributions to secured creditors form their collateral and the payment of claims related to the costs and expenses of administration, proceeds available for distribution should be distributed *pari passu* to the remaining general unsecured creditors. See World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes (2015). See also Fidelis Oditah, “Assets and the Treatment of Claims in Insolvency”(1992) 108 *Law Quarterly Review* 459; Vanessa Finch, “Security, Insolvency and Risk: Who Pays the Price?” (1999) 62 *Modern Law Review* 633.

certain circumstances, for instance, taxes and employees' wages, and, under bank insolvency proceedings, depositors' deposits.¹¹⁰ Nevertheless, nationality does not constitute a legal exemption, and foreign creditors shall be granted with equal treatment as domestic creditors.¹¹¹ Similarly situated domestic and foreign creditors shall be in the same position when liquidating the debtor's assets. The equal treatment not only focuses on the asset distribution and liquidation proceeding but also extends to other creditors' rights such as commencement and participation in the overall insolvency/restructuring proceedings.¹¹²

Similarly, during cross-border bank resolution proceedings, equal treatment shall be granted to all the creditors, regardless of their nationalities.¹¹³ Taking the bail-in measure as an example, the write-down or conversion shall respect the hierarchy of insolvency proceedings.¹¹⁴ Similarly situated creditors, both domestic and foreign, should absorb losses *pro rata*. In addition, there is the no creditor worse off than in liquidation (NCWOL) principle, which guarantees the legitimate interests of creditors during the bank resolution proceedings. And when a creditor is less treated in a resolution proceeding than a normal insolvency proceeding, the creditor shall be entitled to compensation.¹¹⁵ Accordingly, both domestic and foreign creditors should be entitled to compensation afterwards. In the EBL context, if the Chinese creditors are not treated equally during foreign resolution proceedings, it is possible to refuse to recognise or enforce relevant foreign resolution measures on the basis of creditor protection public policy exception.

6 | CONCLUDING REMARKS

China is now a major international market participant and facing a large number of cross-border transactions, which may also involve corporate and bank insolvency issues. Attention should be paid to the upcoming Chinese Bank Resolution Regulation regarding cross-border issues. In terms of the legal framework, Article 5 of the EBL is expected to remain the same in the near future and be the governing law for cross-border bank insolvency and resolution. However, this article only stipulates the recognition and enforcement proceedings and other cross-border issues, such as jurisdiction and applicable law, are not adequately addressed. Without significant amendments to Article 5, cross-border bank insolvency and bank resolution would encounter great uncertainty in the future. Within the current regime, special features of bank resolution should and can be taken into consideration. This paper proposes that the previous legal cases and regulatory practices of financial supervisors could add a valuable

¹¹⁰Mokal extensively discussed the *pari passu* principles and the actual situations where the creditors are not equal. See Riz Mokal, "Priority as Pathology: The *Pari Passu* Myth" (2001) 60 *Cambridge Law Journal* 581. See also Vanessa Finch, *Corporate Insolvency Law Perspectives and Principles* (2nd edn; CUP, 2009), 599–674; Dennis Faber et al., *Ranking and Priority of Creditors* (OUP, 2016). The exceptions are listed in Article 113, EBL; Article 71, CBL.

¹¹¹A similar statement is confirmed by the World Bank, as "effective insolvency systems should aim to ... provide for equitable treatment of similarly situated creditors, including similarly situated foreign and domestic creditors." See World Bank Principles (n 109).

¹¹²UNCITRAL, UNCITRAL Legislative Guide on Insolvency Law, Recommendation 1(d).

¹¹³KA 7.4.

¹¹⁴See the FSB Key Attribute 5.1. It is proposed by the FSB that equity should absorb losses first, and no loss should be imposed on senior debt holders until subordinated debt (including all regulatory capital instruments) has been written-off entirely (whether or not that loss-absorption through write-down is accompanied by conversion to equity).

¹¹⁵The FSB Key Attribute 5.2: creditors should have a right to compensation where they do not receive at a minimum what they would have received in a liquidation of the firm under the applicable insolvency regime.

interpretation to the understanding of Article 5 in its application of cross-border bank insolvency and bank resolution. Based on this article, several issues are clarified and ascertained.

With regard to the outgoing effects of Chinese bank resolution measures, the ultimate decision is in the hands of China's counterparts. However, it is proposed that the contractual approach could be an interim solution in the absence of statutory arrangements. Contractual approaches could be applied to, for instance, bail-in tool and temporary stay on early termination rights.

On the other hand, the incoming effectiveness of foreign resolution measures has to be firstly recognised in China. Three major tests in terms of recognition and enforcement are international agreement, reciprocity, and public policy exception. International agreements should take into account specific banking sector agreements. Reciprocity should be interpreted more broadly so that the court can grant recognition and enforcement without real reciprocity existing in the other jurisdictions before. Public policy exception would still be the safeguard measure and in terms of cross-border bank resolution, financial stability, and equal treatment of creditors should be the main concerns.

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