Research on the pre-bankruptcy procedure of financial institutions

Wei Li

School of Law, Guangxi Normal University, Guilin, Guangxi, 541000, China
547409804@qq.com

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Abstract: Under the system of modern market economy, we should have a relatively complete market access system. Increase its liquidity to make the market vibrant. When stipulating the market launch mechanism, the laws of various countries have also made detailed provisions on corporate legal persons. However, there is also a special kind of enterprise, that is, financial institutions. Due to its special status and influence, its market exit will cause the instability of the national financial system and the risk of the interests of the general public. The world's major countries with mature financial markets have made different levels of regulations on the market exit mechanism of financial institutions to save the financial institutions as much as possible and avoid the bankruptcy of financial institutions.

1. Introduction

1.1 Summary of pre-bankruptcy proceedings of financial institutions

Financial institutions are the carrier of financial markets and the medium between financial investors and financial financiers. The definition of financial institutions can be roughly divided into narrow and broad interpretations. In a narrow sense, it refers to the financial intermediary structure related to the financial industry, which is a part of the whole financial market, and the most representative industries such as banking, securities, insurance, trust and so on. In this sense, financial institutions play a role as a medium in the entire financial market activities, enabling natural persons, legal persons and unincorporated organizations to connect with financial activities. Broadly refers to: in addition to the above institutions, financial regulators also belong to financial institutions.

Financial institutions are an important link in the modern market economy and a part of the world financial system. Financial institutions mainly include banking, securities, insurance and other industries. Different types of financial institutions have different functions[1]. In general, the main functions of financial institutions are:

- In the market to absorb monetary funds, and its appearance change and build into different types and types of financial products or financial assets, such business has become the liabilities and assets of financial institutions. This is the most essential feature and basic function of all financial institutions;
- On behalf of the financial institutions of customers in the market to trade financial assets, to provide financial transactions services;
- Self-financing financial products, and trading and settlement with customers and different subjects in the market;
- To help customers create financial assets, and these financial assets sold in various forms to other market players;
- Provide investment advice to customers, keep assets and manage assets.

1.2 Overview of pre-bankruptcy proceedings

The pre-bankruptcy procedure, also known as the bankruptcy prevention procedure, refers to the bankruptcy prevention system that clarifies the debt-debt relationship of the bankrupt enterprise itself through the application of the interested parties of the bankrupt enterprise, under the auspices of the court and the participation of the interested parties, to rectify the production and operation of the enterprises with legal reasons and the ability to continue to operate, and to clean up the debt-debt relationship, so as to get rid of financial difficulties and regain the ability to operate.

The pre-bankruptcy proceedings in various countries around the world are mostly applicable to enterprises, and some countries and regions also limit them to specific types of companies. For example, Japan limits the object of reorganization to a joint stock limited company. China’s "Enterprise Bankruptcy Law" does not make special provisions on the applicable objects of the pre-bankruptcy procedure, but the applicable objects of the law are originally limited to enterprises, so the pre-bankruptcy procedure is also applicable to enterprises. Because the application of the pre-bankruptcy procedure will cost high costs and expenses, in practice, only enterprises, especially large enterprises, have the practical significance and value of applying the procedure[2].

All countries in the world have provisions on bankruptcy law, and the pre-bankruptcy procedure is initiated by the application of the applicant. Articles 70 and 134 of China’s "Bankruptcy Enterprise Law" make provisions. The applicants for the pre-bankruptcy procedure include the debtor, the creditor, the debtor’s investor and the financial supervision and management institution of the State Council.

At the same time, when there are several scenarios stipulated in the bankruptcy law, the application for the pre-bankruptcy procedure is preferred. After the pre-bankruptcy procedure is started, all procedures should be suspended or terminated.

1.3 Pre-bankruptcy proceedings of financial institutions

The pre-bankruptcy procedure of financial institutions has not been clearly defined in China’s laws and regulations. The main points of view in the theoretical circle of bankruptcy law are as follows:

Professor Li Shuguang believes that the so-called pre-bankruptcy procedure of financial institutions refers to the procedure set up for financial enterprises such as commercial banks, securities companies and insurance companies before applying for bankruptcy. In practice, financial institutions must be approved by the relevant departments of the State Council before they can enter bankruptcy proceedings.

Professor Wang Shihu believes that the pre-bankruptcy procedure of financial institutions includes both the approval of the financial regulatory agency of the State Council and the takeover and trusteeship of financial institutions. The purpose of this move is to enable the financial institution to resume normal business[3].

No matter what kind of view, it will appear in practice. Before the bankruptcy application of various financial institutions, the financial supervision and management institutions generally have
a procedure of takeover or trusteeship. After the supervision and management department’s supervision or trusteeship, the risk of these financial institutions will be largely controlled. After the trusteeship or takeover, it is evaluated by the supervision and management institution, and then whether to start the bankruptcy procedure is considered.

2. The particularity of the pre-bankruptcy procedure of financial institutions

2.1 The asset composition of financial institutions is special

Most of the funds of financial institutions are mainly composed of two parts: one part is the assets owned by financial institutions, because the nature of financial institutions itself is the company, so the assets owned by financial companies mainly include: the capital contribution subscribed by shareholders when financial institutions were established, the assets obtained in the course of operation and the funds raised through the issuance of their own stocks. The other part is composed of customer assets of financial institutions [4]. These customer assets mainly include deposits absorbed by commercial banks to depositors, funds entrusted by investors in securities companies to invest, insurance premiums charged by insurance companies to policyholders, etc.;

In China’s” Enterprise Bankruptcy Law, ” ” Guidelines for the Protection of Banking Consumers ‘ Rights and Interests, ” ” Guidance on Strengthening the Protection of Financial Consumers ’ Rights and Interests, ” and other legal and normative legal documents, it is clearly stipulated that China’s financial institutions should strictly distinguish between the property of financial institutions themselves and the property of customers. And when financial institutions enter the bankruptcy debt repayment procedure, they can only repay the debt with their own property. However, in the actual operation of China’s financial institutions, the financial institutions’ own assets and customers’ assets are often confused. For example, we are most familiar with the commercial banks, commercial banks tend to absorb the customer’s deposits, and then concentrate the funds to lend to other customers. It is precisely because of this practice, we can imagine that once the financial institutions in the event of a major problem led to the failure of its investment, to the customer’s assets caused a significant loss, the emergence of domino effect led to the financial institutions of the remaining assets is not enough to pay all the debt. In the customer composition of financial institutions, most of them are composed of ordinary people in society. If the above situation occurs in financial institutions, it will inevitably affect social stability[5].

2.2 Bankruptcy of financial institutions has its own particularity

2.2.1 The bankruptcy purpose of financial institutions is special

Article 1 of China’s "Enterprise Bankruptcy Law" clearly states that this law is formulated to standardize enterprise bankruptcy procedures, fairly clean up creditor’s rights and debts, protect the legitimate rights and interests of creditors and debtors, and maintain the order of socialist market economy. This provision expresses that the purpose of the law is to pursue the maximization of the total value of the enterprise and to protect the creditors through a fair mechanism, so as to maintain the order of China’s socialist market economy. However, due to the particularity of financial institutions, their bankruptcy is primarily concerned with safeguarding national financial security and social stability, and protecting the legitimate rights and interests of financial consumers. Therefore, what is advocated for financial institutions is bankruptcy prevention, not promotion of bankruptcy. Therefore, the bankruptcy of financial institutions is fundamentally different from the bankruptcy purpose of general enterprises;
2.2.2 Particularity of the right to apply for bankruptcy of financial institutions

Article 7 of China’s "Enterprise Bankruptcy Law" clearly stipulates that both debtors and creditors have the right to apply to the people’s court for enterprise reorganization or bankruptcy liquidation. However, based on the particularity of financial institutions themselves, Article 134 of the "Enterprise Bankruptcy Law" stipulates that the financial supervision and management institution of the State Council may apply to the people’s court for bankruptcy according to the specific circumstances of financial institutions.

2.2.3 The particularity of financial institutions in the order of bankruptcy liquidation

Due to the different subjects of debt, China has made strict provisions on the order of bankruptcy liquidation. According to Article 113 of the "Enterprise Bankruptcy Law" and Article 2 of the "Provisions of the Supreme People’s Court on the Application of Certain Issues (II) (2020 Amendment)," the deposits of financial consumers shall belong to ordinary bankruptcy claims, ranking the last in the order of liquidation. However, in practice, there have been different situations. For the most typical financial institution-commercial banks, according to the legislative purpose of China’s current "Commercial Bank Law," the law mainly highlights the protection of depositors. In particular, Article 71, paragraph 2, clearly stipulates: "When a commercial bank goes bankrupt, it shall give priority to paying the principal and interest of personal savings deposits after paying the liquidation expenses, wages owed to employees and labor insurance expenses[6]."

2.3 Financial institutions have a special position in the socialist market economy

Under the background of China’s socialist market economy, financial institutions play a vital role in ensuring the sustainable development of the national economy, safeguarding national economic security and maintaining the stability of the financial market order. Once China’s financial market turmoil, it will lead to the stability of China’s overall economy, and even the impact on the world economy is very huge. As an important financial institution participating in the socialist market economy, ensuring its normal operation is also an important means to maintain the stable development of China’s financial market. Based on the above, we know that the main function of financial institutions in the socialist market economy is to provide credit services and raise funds for investors in the market. It is an important financing channel for investors to expand their operations and consumers to protect themselves. If a financial institution fails, it will not only harm the interests of customers, but also cause market fear, resulting in the lack of financial channels for enterprises, eventually leading to the stagnation of the whole social and economic development, and even the occurrence of financial crisis.

3. The status quo of the pre-bankruptcy procedures of American financial institutions

In the context of inflation in the 1970 s, the UK took over banks for the first time, thus avoiding the emergence of a financial crisis in the country. We know that a country’s financial crisis will produce a chain reaction, which will lead to the occurrence of regional or even global financial crisis. Since then, other countries with more developed financial markets have also established their own pre-bankruptcy procedures for financial institutions to maximize the control of financial institutions. Risk. After more than 40 years of continuous development, the relevant laws and regulations of many developed countries and regions in the world have gradually become mature and perfect. Due to the late development of China’s market economy, there is still much room for financial institutions and even the entire financial market to develop. Therefore, it is necessary to learn from and refer to the advanced legislative experience of foreign countries when constructing
the bankruptcy prepositional procedure of financial institutions in China [7].

3.1 Overview of the pre-bankruptcy procedures of American financial institutions

The United States is one of the most developed countries in the global financial market. In order to regulate and maintain order in such a huge financial market, the United States has formulated relatively perfect financial regulations at the legal level. As a very important hub and link in the financial market, financial institutions in the United States have formulated more thorough laws and regulations.

3.2 Reasons for starting the pre-bankruptcy procedure

For commercial banks that may have a credit crisis, the United States mainly solves the credit crisis of commercial banks through takeover measures in legislation. In terms of the reasons for the takeover, the relevant laws of the United States have made detailed provisions and carefully listed 13 items. These reasons are also the trigger of the credit crisis that may occur in the more classic commercial banks. For example, the bank’s assets are less than its deposits and administrative obligations, which has constituted bankruptcy; for example, the bank hides its books, documents, records or assets or refuses to submit its books, documents, records or events for review by its appropriate regulatory body. In order to prevent the inconvenience caused by the emergence of new situations, article 12 of the law also stipulates the words "other circumstances" and reserves the exercise of the power of the supervision and management department;

3.3 The characteristics of the pre-bankruptcy proceedings of American financial institutions

U.S. law adopts enumerative legislation on the reasons for initiating the pre-bankruptcy proceedings of financial institutions. As mentioned above, the United States adopts enumerative legislation, through detailed and specific provisions to specify the situation, for the financial regulatory authorities to implement the pre-procedure to provide a more clear basis. It avoids the implementation disputes caused by unclear regulations, further reduces the discretion of the financial supervision and management department, and prevents the supervision department from abusing the starting right and wasting public resources;

The supervision and management department is limited by the minimum cost principle. Although the U.S. financial regulatory authorities have a certain degree of discretion, the principle of minimum cost also gives this discretion a clear limit. The purpose of this move is to protect the public interest of the whole society, minimize the consumption of public resources, and avoid waste. In addition, if things in the pre-procedure lead to the failure of its rescue plan, it will not only damage the rights and interests of the financial institution, but also cause greater losses to the public resources of society.

There are a wide range of scenarios in which U.S. financial institutions initiate pre-bankruptcy procedures. Most countries in the world have vague provisions on the pre-bankruptcy procedures for financial institutions, and the conditions for their initiation are also very harsh, such as major financial crises and inability to operate normally. The purpose is also to expect financial institutions to change their predicament by using the laws of operation and market, rather than relying on the power of administration and the state. However, the conditions in the United States are very rich, including not only the special hardships prevailing in other countries, but also the deterioration of capital, hidden books, substantial waste of assets and other situations that cannot be supported by financial institutions. Its purpose is to emphasize the important position of capital in the market. In order to preserve the capital in the market, this broad condition facilitates the early intervention of
the financial supervision and management institutions, and eliminates the problems in the early stage, without reaching the irreparable situation. It will not affect the entire financial market, so that the financial institutions involved can have greater hope and possibility to resume normal operations [8].

4. Current situation and defects in the pre-bankruptcy procedure of financial institutions

4.1 Conflicts between judicial power and administrative power

According to the provisions of Article 134 of China’s "Enterprise Bankruptcy Law": The financial supervision and administration institution of the State Council shall take measures such as takeover and trusteeship of financial institutions with major business risks in accordance with the law. According to this article, it can be learned that the application of the pre-bankruptcy procedure of financial institutions belongs to an administrative power originating from the financial supervision and management institution of the State Council, and belongs to the administrative coercive measures in the administrative power.

From the perspective of the leading organ of bankruptcy proceedings, according to the current "Enterprise Bankruptcy Law," the bankruptcy proceedings of ordinary enterprises, whether their initial bankruptcy declaration or the appointment of the bankruptcy administrator, and the final bankruptcy declaration, are dominated by the court. Moreover, in the process of applying the pre-bankruptcy procedure of financial institutions, the relevant legal subjects of financial institutions that have been taken over or entrusted can apply for the help of judicial channels such as bankruptcy and reorganization by filing a lawsuit.

4.1.1 Administrative litigation

It can be seen from the above that the pre-procedure for the bankruptcy of financial institutions is the exercise of administrative power. Then after the financial institution is trusteed and taken over, the receiver, the trustee and the interested parties can file an administrative lawsuit against the pre-bankruptcy procedure based on the exercise of this administrative power.

In this realistic situation, although the pre-bankruptcy procedure can still continue to be implemented, once it is put into the long judicial proceedings, it will inevitably consume the financial supervision department and the human and financial resources of the receiver or custodian. This not only increases the burden on financial institutions, but also adds burden and resistance to subsequent implementation.

4.1.2 Reorganization

In addition to the above-mentioned stakeholders, they can resort to administrative litigation procedures. The receiver, the trustee and the relevant interested person can apply to the court for institutional reorganization, that is, to apply for entry into the reorganization process. Under the above circumstances, the court can enter the bankruptcy reorganization procedure directly according to the provisions of Article 70 of China’s "Enterprise Bankruptcy Law," after the application of the receiver, the trustee and the relevant interested parties, and after the court’s review, it is considered to meet the legal conditions of reorganization. According to the principle of judicial priority, when the court rules that financial institutions enter the reorganization process, it means the termination of the pre-bankruptcy procedure.
4.2 The applicable conditions of pre-bankruptcy proceedings are too general.

In the current laws and regulations of our country, the applicable conditions of the pre-bankruptcy procedure are mainly reflected in the departmental laws of various financial institutions. The reason why China should set up such a legislative model is mainly to take into account the different nature and characteristics of different financial institutions. It is expected that the detailed and differentiated provisions of the departmental law can be accurately applied to different situations. However, in China’s current departmental law on financial institutions, the provisions on the application of pre-bankruptcy procedures are relatively simple, and even some procedures have not been stipulated. This makes there is no appropriate legal basis for the application of pre-bankruptcy proceedings in financial institutions.

According to the provisions of Article 64 of the "Commercial Bank Law": When a commercial bank has or may have a credit crisis, which seriously affects the interests of depositors, the State Council’s industry supervision and management institution may take over the bank. There are also relevant provisions in another law, that is, Article 38 of the ‘Banking Supervision and Administration Law’ stipulates that if a credit crisis has occurred or may occur in a banking financial institution, which seriously affects the legitimate rights and interests of depositors and other customers, the banking supervision and administration institution under the State Council may take over or facilitate institutional restructuring of the banking financial institution in accordance with the law, and the takeover and institutional restructuring shall be implemented in accordance with the relevant laws and the provisions of the State Council. The above two provisions on the pre-bankruptcy procedure of commercial banks have appeared in the statutory situation. That is, when a credit crisis occurs. The so-called credit crisis refers to the phenomenon that excessive expansion of credit leads to inflation and economic turmoil, which in turn affects the balance of the credit system and leads to the collapse of its various links. This explanation is too general and vague, and it is flexible in the specific application of reality. This flexibility also affects the judgment of financial regulatory authorities. In addition, the legal provisions of the 'serious impact on the interests of depositors', this means that the word 'serious' is also uncertain, what is the degree of serious? What is the serious measure? This is difficult for regulators to judge.

4.3 The pre-bankruptcy procedure does not specify the scope of the applicant.

The initiation of the pre-bankruptcy procedure is determined by the corresponding regulatory authorities according to the existing legal provisions. However, before the financial supervision department decides to implement it, whether the takeover or custodian financial institution and its stakeholders can apply for the implementation of the pre-bankruptcy procedure is not stipulated in the relevant law.

According to the provisions of Article 64 of the "Commercial Bank Law," when a credit crisis has occurred or may occur in a commercial bank, which seriously affects the interests of depositors, the banking supervision and management institution of the State Council may take over the bank. Article 6 of the "Regulations on Risk Disposal of Securities Companies" stipulates that the securities regulatory agency of the State Council may dispatch a risk monitoring on-site working group to conduct special inspections of securities companies, monitor the operation and management activities of securities companies, such as allocating funds, disposing assets, allocating personnel, using seals, concluding and fulfilling contracts, and inform the relevant local people’s governments in a timely manner. Article 144: If an insurance company has any of the following circumstances, the insurance regulatory authority under the State Council may take over the insurance company. According to the special laws of the above three financial institutions, it can be known that only when the financial institutions have the legal provisions applicable to the takeover
or trusteeship, the relevant regulatory authorities of the financial institutions can decide whether to apply the trusteeship or takeover procedures. It is precisely because of this that China’s financial regulatory authorities cannot find that financial institutions are taken over or entrusted at the first time every time. Therefore, when the above situation occurs, it is necessary for the parties and interested parties to decide whether to start the takeover or trusteeship procedure. That is to give the parties, the interests of the right to apply. In order to protect the legitimate rights and interests of the stakeholders of financial institutions, it is necessary to give them the right to apply for trusteeship or takeover when the improper behavior of financial institutions damages the interests of depositors, investors and other relevant subjects.

5. The perfect countermeasures in the pre-bankruptcy procedure of financial institutions

5.1 Determining the scope of applicants for bankruptcy pre-procedures

In the pre-bankruptcy procedure of financial institutions, the scope of applicants should be clearly defined. After determining the scope of its applicants, it will be able to ensure that the financial regulatory authorities can find the situation in which the pre-bankruptcy procedure can be applied in the first time, and can quickly decide whether to apply the pre-bankruptcy procedure after discovery. As mentioned above, in our country’s laws and regulations, the scope of the applicant is vague and cannot respond to it at the first time. Moreover, China’s financial market has not yet been perfected and formed in terms of supervision and self-discipline. Therefore, when financial institutions have situations where bankruptcy pre-procedures can be applied, even when major legal acts are committed, it is difficult for financial regulators to find them in the first time. This lagging mechanism of supervision will lead to greater losses in financial institutions that are taken over or managed until they lose the state of normal operation. Thus, the significance and purpose of the existence of the ‘ enterprise bankruptcy law ’ are lost. When determining the applicant for the pre-bankruptcy procedure. We should start from the following aspects.

5.1.1 Clarify the scope of the applicant

The applicant for the pre-bankruptcy procedure of a financial institution should be a person with an interest in the financial institution. The so-called people who have an interest in the financial institution are divided into direct stakeholders and indirect stakeholders. The direct interested party refers to the person who has the right to sue or be sued in court based on the relationship of the financial institution. Indirect stakeholders are those who have no direct interest between the parties based on the financial institution, but the loss of one of the parties may bring adverse consequences to themselves, and can participate in the litigation and have a certain position in the litigation. Based on the above, the person who has an interest in financial institutions refers to the creditors, investors, customers and other stakeholders of financial institutions. Giving customers and other indirect stakeholders their rights is to protect their legitimate rights and interests.

5.1.2 Determination of the applicant's right to apply

After determining the scope of the applicant, the applicant should be legally given the right to apply. The legal subject without rights is not the legal subject. When the applicant has the right to apply for the pre-bankruptcy procedure of the financial institution, the parties can apply when the pre-bankruptcy procedure is applicable, and the financial supervision department can apply the pre-bankruptcy procedure to the financial institution at the first time. The applicant should make an application to the financial supervision department. After receiving the application of the parties, the financial supervision department should make a reply to the applicant within 5 days.
supervision and management department refuses to accept the application, it should give a written reply and give a written explanation.

5.2 Perfect the applicable conditions of the bankruptcy prepositional procedure

5.2.1 Drawing on the U.S. enumerative model

According to the characteristics of various financial institutions, the application of pre-bankruptcy procedures with different styles and detailed characteristics is listed. The laws of all kinds of financial institutions have their own different characteristics. The different characteristics are mainly reflected in the different purposes and purposes set up by the department law. For example, Article 1 of the Commercial Bank Law stipulates that this law is formulated in order to protect the legitimate rights and interests of commercial banks, depositors and other customers, standardize the behavior of commercial banks, improve the quality of credit assets, strengthen supervision and management, ensure the stable operation of commercial banks, maintain financial order, and promote the development of socialist market economy. Article 1 of the Insurance Law stipulates that this Law is formulated in order to standardize insurance activities, protect the legitimate rights and interests of the parties to insurance activities, strengthen the supervision and management of the insurance industry, safeguard social and economic order and social public interests, and promote the healthy development of the insurance industry. From this comparison, it can be seen that the purpose and purpose of the two financial institutions are very different. The application of the listed pre-bankruptcy procedures should also be compared with the legislative purposes of their respective departmental laws, and the characteristics of financial institutions with different natures should be highlighted. So that the applicable situation enumerated has the generality of the bankruptcy prepositional procedure, and can reflect its own characteristics.

5.2.2 Introduce the concept of cost

When there is a pre-bankruptcy procedure that can be applied to financial institutions, the financial supervision department should comprehensively judge the actual situation of the applicable subject, and compare the pre-bankruptcy procedure with other rescue methods such as bankruptcy reorganization procedure. The purpose of the pre-bankruptcy procedure of financial institutions is to make the financial institutions on the verge of bankruptcy return to the normal operation track through a series of methods and measures to ensure economic development and social stability. In the implementation of these rescue methods, the administrator needs to be designated, and the implementation of a series of rescue programs is the responsibility of the administrator. Other costs such as the cost of management in the implementation process will also be included in the cost of the financial institution. This cost will also become a burden on the financial institution, and may also be the last straw that overwhelms the camel. Therefore, when the pre-bankruptcy procedure of financial institutions is applied, the financial supervision department as the approval authority should also introduce the concept of cost into the conditions of comprehensive judgment. Only when the cost of implementing the pre-bankruptcy procedure is the smallest and the purpose of the procedure is realized, can the financial supervision department decide to apply the pre-bankruptcy procedure.

6. Conclusion

Incorporating the bankruptcy of financial institutions into the scope of the "Enterprise Bankruptcy Law" is an important step to improve the market-oriented exit mechanism of China’s financial institutions, and also an important measure to maintain the healthy and sustainable
development of China’s financial market. Therefore, combined with the particularity of financial institutions and their bankruptcy, we should respond to the actual needs, provide sufficient legal basis for the market-oriented exit mechanism of financial institutions, and promote the healthy, sustainable and stable development of China’s financial industry.

References