



## China's Current Consumer Bankruptcy Situation

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## ***China's Current Consumer Bankruptcy Situation***

A deep dive into how China handles Consumer Bankruptcy and what future solutions are beginning developed in the future.

With the current global unstable economic situation and China's proactive approach to cracking down on debt, LehmanBrown International Accountants collaborated with BIRT International Restructuring[1] to look into how China deals with Consumer Bankruptcy.

China currently has no specific consumer bankruptcy laws at a national level. Historically, bankruptcy was a criminal act that previously could result in repeat offenders' death penalty because bankruptcy was "not permitted by heaven and earth, and an extraordinary crime against society"[2]. Furthermore, the local custom was to then pass on debt to the next of kin to where the children would repay the father's debts (父债子偿)[3].

China since those early day has made huge leaps forward where individual bankruptcy now leads to offenders lose face (没有面子) and face disadvantages when dealing with bankruptcy dealings.

However, there is still unease from creditors as a way for individual debtors to use it as a loophole avoiding their financial obligations, as the "personal insolvency" laws are not yet included in the Chinese legislation.

Be that as it may, China has enacted in 2007 an insolvency regime, which was inspired by European models that apply to "enterprise legal persons" (corporates), while excluding consumers. That said, China's judiciary has within the existing legal framework established case law dealing with personal bankruptcies. Furthermore, Shenzhen has recently played a pioneering role by implementing China's first individual bankruptcy regime.

## **Shenzhen and Wenzhou Leading the Way**

Wenzhou is a city in the Zhejiang Province. In September 2019, the Wenzhou intermediary court had published the Implementing Opinions on the Centralised Clean-up of Personal Debt (关于个人债务集中清理实施意见)[4]. In October 2019, what was considered China's first individual bankruptcy case was closed with approval of a settlement agreement between a shareholder of the insolvent company and four creditors, following the published Implementing Opinions.

More recently in Shenzhen, in June 2020, the Standing Committee of the People's Congress of Shenzhen Municipality[5], drafted the Shenzhen Special Economic Zone Personal Bankruptcy Regulations (关于《深圳经济特区个人破产条例(征求意见稿)》公开征求意见的公告) and the Regulations on Personal Bankruptcy in the Shenzhen Special Economic Zone - Explanatory note on the draft Exposure Draft (关于《深圳经济特区个人破产条例(征求意见稿)》的说明), which were inspired by global modern markets' international standards. The Regulation, which came into effect on 01 March 2021, aims at constructing a complete and modern bankruptcy system and providing a way out for honest but unfortunate individuals saddled with debts they are unable to repay.

### Where Would one Apply for Consumer Bankruptcy Proceeding?

From the Wenzhou Implementing Opinions, the answer is the Basic People's Court in the place of residence of the debtor, the specific court which has dealt with such cases, or the court which had initially been received and accepted the case. As from the Shenzhen Regulation, the jurisdiction is with the Intermediate People's Court of Shenzhen Municipality.

### Who Would be In-Charge of Consumer Bankruptcy Proceedings?

The court where the proceeding is taking place has the decision-making power; however, the court appoints an administrator to the case. The Wenzhou Implementing Opinions suggests that an administrator should cover both the enterprise (creditors) and the "natural person" (individual) in cases of enterprise insolvency. In other cases, the court can appoint an administrator, or the debtor and creditors can jointly agree on an administrator based on a creditor's meeting. Debt settlement administrators will have to take care of transactional work in the proceedings, and any work deemed necessary by the court while supervising the debtor and sharing information with creditors.

If the debtor does any violations, it can be reported to the administrator, who can report to the court to resume the execution of the original judgement. The administrator should also inform the creditors in writing within 20 days from the day the court officially accepts the petition and make the announcement public[6].

Shenzhen's Regulation suggests that the court appoints the administrator, but creditors can make recommendations about a possible administrator. The latter will carry out duties as described in the Regulation, including informing the creditors, while being supervised by the People's Court.

Depending on the bankruptcy case and the administrator's report, the People's Court has the ultimate decision on whether to discharge the individual's debt or not.

### What Requirements are there for Consumer Bankruptcy Proceedings?

According to the Wenzhou Implementing Opinions, the individual debtor must lack assets and funds to cover the debt owed to the creditors and be declared bankrupt by a court. The review for bankruptcy, including the review of an individual's assets and funds, is also comprised of checks on the spouse's funds and assets, while family members are encouraged to cooperate and provide their information as well. Other criteria include checking if there are no ongoing or solved cases outside of Wenzhou related to the consumer bankruptcy case and confirming if creditors outside of Wenzhou agree to participate in Wenzhou's proceedings.

There are criteria's also for refusing the consumer bankruptcy case if the individual has neglected to come forth with assets or funds that were later discovered, has a history of extravagant consumption and unhealthy behaviours, or has tried to adhere to a previous court ruling and seems to attempt evasion from paying debtors. Essentially the consumer cannot file for consumer insolvency if they are clearly trying to avoid paying the creditors.



Meanwhile, the Shenzhen Regulation offers two ways for consumer bankruptcy to be filed. The first is for the individual consumers to file themselves. However, they have to be registered in the Shenzhen Special Economic Zone, contributed to the Shenzhen social insurance system for three years, and the assets and funds have to be insufficient to cover the debt.

The second method is for the creditors to file for individual bankruptcy of the debtor, as the individual has failed to meet payment deadlines for debts higher than 500,000 RMB. The threshold is meant to prevent creditors from abusing the bankruptcy process.

### Costs and Timeframes

According to the Wenzhou Implementing Opinion, the creditors cannot have their expenses paid by the individual debtor. As for filing the claims, it is between 30 days and three months from when the administrator makes the official public announcement.

Shenzhen's Regulation suggests that the expenses will be considered as bankruptcy expenses, including litigation, distribution of debtor's assets, administrator's expenses, and other related expenses to the case. For the time frame, it will be 30 days for the People's Court to decide to accept or not and it can extend the time by 15 days.

## Testing Individual's Bankruptcy and Restrictions

The Wenzhou Implementing Opinions suggests the individual will have all their assets, funds and debts reviewed. What the debtor can keep will depend on the debt repayment plan, which the creditors and the court approve. Once the repayment plan is completed, the debtor is liable from his future income for certain liabilities unless creditors allow for a reduction on the claim.

Once the Consumer Bankruptcy case is initiated, the court will establish a restraining order on the individual debtors, which will prohibit them from conducting high consumption spending such as travelling first class, having a legal representative role in for-profit companies and State-owned enterprises, and other restrictions as deemed necessary by the court. If the individual has to travel abroad, the court will have to pre-approve.

Shenzhen's Regulation is very similar; however, the court can go further to prohibit individual debtors from spending in luxury hotels, nightclubs, golf courses or anywhere with a higher than three-star rating, they cannot purchase real estate or vehicles, renovate, partake in tourism, sending children to expensive private schools, investing in high-end real estate, and other non-essential luxuries for life and work.

## How will the Claims be treated in the various Proceedings?

In the Wenzhou Implementing Opinions, there it is not yet clearly defined on how the process should be conducted, suggesting to follow the principle of autonomy of will of the creditors. The creditor's meeting will vote on the repayment plan provided by the individual debtor, including the treatment of the different claims.

According to the Shenzhen Regulation, the settlement of the creditors' meeting will be voted on by the majority of creditors present and creditors they represent. The settlement will be adopted by half of the total amount of unsecured claims.

### Reorganization Proceedings

The reorganisation plan will be submitted to be approved by the meeting of creditors, and the Shenzhen Regulation demands that the voting be conducted following specific groups from claims that have security rights on property to general claims.

If necessary, the People's Court can create a smaller claims group to vote on the draft reorganisation plan; for the plan to pass, it will require more than half of the creditors, which during the meeting must represent two-thirds of the amount claimed by the group. The plan is only adopted when all creditor groups approved the plan and then submitted to the People's Court. Once approved by the court, the reorganisation plan is binding to everyone involved. If the reorganisation plan does not reach the quorum, the court can approve it, or the debtor will be declared bankrupt.

### Composition Proceedings

A meeting will have to be conducted with creditors representing at least two-thirds of the claims to confirm the claims' composition and vote on the composition agreement. If there are adjustments to the secured claims, there will be a specific meeting with the secured claims group and creditors affected to vote. Here also, the meeting has to represent two-thirds of that claim composition and achieve a majority to pass[7].

### Bankruptcy Liquidation Proceedings

Once the People's Court has declared an individual bankrupt, the holder of the security interest of a property can at any time submit a request to the administrator to gain payments by disposing of the property in question. If such transactions do not fully pay off the creditor, then what is unpaid is considered still claimable[8].

Furthermore, once it has been allowed the discharge of bankruptcy expenses and debts of the creditors, other debts can be discharged such as child support, wages, medical assistance and so forth. If the assets and funds are insufficient, then the distribution will be made proportionally.

Meanwhile, the individual's finances will be monitored for at least three years, considered as a probationary period, before part or all their responsibilities are partially or totally wiped[9]. However, the Shenzhen Regulator will not clear certain types of debts unless voluntarily waived by the creditors themselves.

## What to Expect in the Future?

Considering the historical-cultural setting that China has with dealing with individual consumer debt, these developments in Wenzhou and Shenzhen are an incredible step towards realising the modern consumer market. Even though it is now limited in those areas, China will at some point likely codify into the national law such rules to effectively deal with consumer bankruptcy. Such reforms will for instance protect unlucky founders and manager of SMEs and start-ups by having their debt removed or reduced by creditors which will boost China's entrepreneurial spirit.

### How can we help you?

LehmanBrown can help companies and individuals through its senior experienced experts to prevent overseas business and investors from entering into poor business ventures by conducting thorough background checks as part of the due diligence services. Alternatively, LehmanBrown's experts have also managed to redistribute the debt and establish actionable recovery plans, putting clients back on track.

To find out more how either LehmanBrown can assist in helping you or your business with bankruptcy or ultimately helping to get back to business, please enquire at [enquiries@lehmanbrown.com](mailto:enquiries@lehmanbrown.com)

To further explore the legal side of bankruptcy and debt issues, reach out to Roger Bischof ([bischof@international-restructuring.com](mailto:bischof@international-restructuring.com)), the Managing Partner of BIRT International Restructuring who wrote the above mentioned INSOL technical paper.

## Sources

- [1] For a detailed legal analysis see Roger Bischof, INSOL technical paper on the People's Republic of China (PRC) "Consumer Debt Issues", November 2020, [www.international-restructuring.com/wp-content/uploads/2020/11/INSOL-paper-PRC-consumer-debt-issues.pdf](http://www.international-restructuring.com/wp-content/uploads/2020/11/INSOL-paper-PRC-consumer-debt-issues.pdf).
- [2] Pengsheng, The Discourse on Insolvency, in: Hegel / Carlitz (ed.), Writing and Law in Late Imperial China – Crime, Conflict and Judgment, 2007, 128.
- [3] Guo, The first personal bankruptcy case in China, 18 October 2019, available at: <https://leidenlawblog.nl/articles/first-personal-bankruptcy-case-in-china>.
- [4] The Wenzhou Implementing Opinions consist of 44 articles.
- [5] The high-tech city with 13 mio. inhabitants borders Hong Kong and is commonly known as China's Silicon Valley.
- [6] Wenzhou Implementing Opinions, Art. 19.
- [7] Shenzhen Regulation, Art. 119.
- [8] Shenzhen Regulation, Art. 28.
- [9] Shenzhen Regulation, Art. 95.



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