

Establishment of the Personal Bankruptcy System in China

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Abstract: The Regulations of Shenzhen Special Economic Zone on Personal Bankruptcy, China's first-ever statute addressing personal bankruptcy, came into force in 2021, bringing the concept of personal bankruptcy system into public awareness for the first time. Under the current Chinese judicial framework, individuals bear unlimited liability for their debts, leaving debtors unable to anticipate risks in advance and sometimes powerless to meet their obligations afterward. In this context, a Personal Bankruptcy System can remedy deficiencies in the existing system. However, as an imported institution, it must be adapted to China's national conditions to ensure its steady, sustainable development and advance the rule of law. This paper reviews the origins and characteristics of personal bankruptcy, analyzes China's efforts to establish such a system, and offers prospects for its future evolution.

1. Clarification of Fundamental Issues in Personal Bankruptcy

1.1 Origins and Development of the Personal Bankruptcy System

The concept of Personal Bankruptcy traces back to ancient Rome. At a time when the Roman economy flourished, the Twelve Tables codified property enforcement procedures—seen as the embryo of bankruptcy law. During the medieval period in Italy and England, personal bankruptcy statutes evolved further. England's An Act against such Persons as Do Make Bankrup is recognized as the first codified personal bankruptcy law worldwide. Early frameworks prioritized creditors' interests exclusively, often leaving bankrupt individuals destitute, incarcerated for debt, or even sold into servitude or worse [1]. With the advent of the free estate doctrine, legislation began exempting certain debtor-personal property—such as maintenance allowances—and other protected assets from seizure. The U.S. Bankruptcy Code of 1978 formally incorporated consumer bankruptcy, marking personal bankruptcy as an integral component of modern bankruptcy law. France, Germany, Japan, Singapore, and others followed suit, embedding personal bankruptcy within their civil legal systems.

1.2 Characteristics of the Personal Bankruptcy System

While the broad concept of bankruptcy covers both personal and corporate bankruptcy [2], personal bankruptcy exhibits distinctive features [3]:

First, with the passage of time, the objectives and purposes of personal bankruptcy have become increasingly diversified. As noted above, in its early stages personal bankruptcy was designed primarily to punish debtors and to secure the interests of creditors. However, the modern bankruptcy system pursues a broader set of values: it no longer aims solely to protect creditors' claims and effect simple debt repayment, nor simply to redeem debtors from all burdens. Rather, it seeks a balanced trade-off, ensuring that creditors' rights are lawfully protected and reasonably satisfied while also offering honest but unfortunate debtors an opportunity for a fresh start, thus effectively easing tensions in the debtor-creditor relationship.

Moreover, personal bankruptcy estates inherently bear a strong personal dimension. When determining which assets enter the bankruptcy distribution, one must take into account various personal-status legal facts—such as inheritance rights, maintenance obligations, and assets possessing a personal character tied to the debtor—which translate into exemptions within a personal bankruptcy system. This principle is also reflected in the common practice of setting a minimum subsistence threshold, whereby a portion of the debtor's assets is reserved to meet basic living needs and to ensure that the individual retains a source of livelihood post-bankruptcy. For example, the Regulations of Shenzhen Special Economic Zone on Personal Bankruptcy explicitly enshrine the principle of protecting the debtor's—and any dependents'—rights to subsistence and development, making clear that the primary purpose of the exemptions regime is to safeguard the basic living standards of the debtor and those they support.

2. China and the Personal Bankruptcy System

2.1 Reasons for China's Historical Absence of a Personal Bankruptcy System

The personal bankruptcy system entered the legislative agenda in China more than a decade ago. The Enterprise Bankruptcy Law of the People's Republic of China, passed in 2006, took 12 years to draft [4]. During the discussions, the draft provisions regarding personal bankruptcy sparked debate and were ultimately removed. The opposition primarily focused on two concerns. First, in the absence of a supportive institutional framework at that time, introducing personal bankruptcy as a legislated system could lead to abuse, resulting in social consequences contrary to the legislative intent. The development and refinement of relevant laws, regulations, and systems required extended research and preparation, and implementing personal bankruptcy without this foundation would undoubtedly cause various systemic issues. There were concerns that the hasty introduction of personal bankruptcy could encourage individuals to maliciously borrow and squander funds, only to later escape their debts through bankruptcy [5].

Another consideration was the focus on corporate entities. During China's rapid economic growth and transformation in recent decades, with the urgent need to address state-owned enterprise bankruptcies, most lawmakers believed the legislative focus should be placed on establishing and refining corporate bankruptcy procedures to meet the needs of economic reform and enterprise development. Additionally, from a cultural and traditional perspective, China has long been influenced by Confucian family order. Under traditional ideas such as “a son repays his father's debts” and “debts must be repaid, it is a matter of course”, the concept of personal bankruptcy lacked the cultural foundation to thrive. Even today, many ordinary people instinctively reject the foreign term “bankruptcy” considering it disgraceful and something to be avoided, with a generally negative social evaluation of “personal bankruptcy”.

These factors combined to delay the formal adoption of personal bankruptcy in Chinese law.

2.2 The Imperative Need for Establishing a Personal Bankruptcy System

2.2.1 Rebirth of Honest and Well-Intentioned Debtors

The roles in economic life are diverse and fluid; everyone can potentially become a debtor or a creditor. The establishment of a personal bankruptcy system can benefit everyone within the system, regardless of whether they are in the position of a creditor or a debtor, as long as they adhere to the rules. The establishment of a personal bankruptcy system provides legal norms that guide the actions of every participant in the socialist market economy, enabling individuals to act within the boundaries set by the relevant regulations and engage in sound economic activities under the premise of adhering to the personal bankruptcy system.

When an individual debt crisis arises, debtors facing such crises must bear unlimited joint liability for their debts. This means that, in the absence of a personal bankruptcy system, debtors may continue to carry their debts indefinitely, potentially to the point where they are unable to secure even their basic living needs. Meanwhile, creditors might also be unable to fully recover their claims, leading to situations where a single unfortunate investment could disrupt their subsequent business activities and even affect their livelihood. The establishment of a personal bankruptcy system can, when a debtor is unable to pay, provide legal norms that ensure their basic living and production needs are met, while still maintaining the fulfillment of the debt. It ensures that the creditor's debt can be stably repaid. Under such a system, both debtors and creditors become beneficiaries [6].

It is important to note that personal bankruptcy does not indicate a loophole in the law that allows individuals to escape their debts. The conditions for applying this system are strictly regulated by law. Only honest and well-intentioned debtors who meet the legal criteria are eligible to benefit from it. Outside of these conditions, the application of the system is not possible.

2.2.2 Filling Gaps in Existing Law

Firstly, the establishment of a personal bankruptcy system can fill the gaps in the current bankruptcy law and respond to the needs of higher-level laws. For a long time, due to the lack of a personal bankruptcy system, the Enterprise Bankruptcy Law of the People's Republic of China has been referred to within the industry as a "half bankruptcy law" [7]. With the continuous deepening of economic construction and the constant evolution of business development, it has become increasingly convenient and frequent for natural persons to participate in commercial activities. During this process, issues related to "personal bankruptcy" have emerged, especially those concerning the joint liability guarantee for debts of natural persons resulting from corporate bankruptcy. The gap in the bankruptcy law regarding personal bankruptcy must be addressed to meet both theoretical and practical needs. On the other hand, the establishment of a personal bankruptcy system also responds to the needs of higher-level laws. In the field of civil law, the Civil Code of the People's Republic of China divides civil subjects into three categories: natural persons, legal persons, and unincorporated organizations. The Enterprise Bankruptcy Law of the People's Republic of China, however, directly defines the applicable subject as corporate legal persons, excluding natural persons from its scope. The diversity of civil subject classification in higher-level laws is not reflected in this singular classification. Advancing the establishment of a personal bankruptcy system will not only reform the bankruptcy legal system to address the challenge posed by the Civil Code of the People's Republic of China, but it will also maintain the logical integrity of the civil legal system.

Secondly, the establishment of a personal bankruptcy system can address the existing legal gap related to the “non-enforcement” of debt collection. In judicial practice, there is a category of extreme debtors who evade debt repayment by various means, believing that “more lice don’t itch” and “escape is shameful but effective”. In such cases, while creditors may theoretically pursue unlimited recovery, they may actually struggle to benefit. Although Article 162-2 of the Criminal Law of the People’s Republic of China and Article 131 of the Enterprise Bankruptcy Law of the People’s Republic of China mention the use of criminal measures to punish fraudulent bankruptcy, the relevant provisions are vague and not easily applied in legal practice [8]. Even when a judgment is in effect, if the debtor has no money to repay, enforcement is often forced to be suspended, resulting in a deadlock for both the debtor and the creditor. The absence of a personal bankruptcy system is one of the key reasons for the “non-enforcement” of personal debts. Under a personal bankruptcy system, debtors in debt crises can declare bankruptcy, provided they meet the legal conditions, which will relieve part of their debt while protecting creditors, resolving some “non-enforcement” cases, and preventing a judicial impasse.

2.2.3 Aligning Domestic and International Economies

Some scholars have pointed out that, from the perspective of global economic integration, the personal bankruptcy system is no longer merely a mechanism to help individuals escape debt crises. A country also needs this system to address economic crises, promote economic development, and effectively safeguard people’s livelihoods [9]. As the pace of global economic and social integration accelerates, domestic and international economies are increasingly interconnected with the global economy, and every mechanism should gradually align with international standards. Unlike China, most countries currently adopt a general model that simultaneously recognizes the bankruptcy capacity of corporations, unincorporated organizations, and natural persons. However, when China’s national, organizational, and individual entities participate in the overall international economic landscape, this system does not provide effective protection for the rights and interests of these subjects, signaling the need for the timely establishment of a personal bankruptcy system.

In the increasingly close international commercial exchanges, Chinese citizens may become creditors or debtors in international commercial transactions. For instance, if a Chinese citizen becomes a creditor, involving a case of personal bankruptcy of a foreign national within China, due to the absence of a personal bankruptcy system, Chinese People’s Courts would be unable to declare the foreign national bankrupt based on domestic bankruptcy law and the application of Chinese citizens. Consequently, the creditor’s claim would be difficult to protect through bankruptcy procedures. Conversely, if a Chinese citizen becomes a debtor, due to the lack of relevant provisions, they cannot be declared bankrupt within China. In this case, foreign creditors might apply for bankruptcy in accordance with foreign bankruptcy law. If a Chinese citizen is declared bankrupt abroad, and the foreign court extends the bankruptcy effects to China and seeks to seize the debtor’s domestic assets, Chinese People’s Courts would find it difficult to act to protect the interests of Chinese citizens [10].

3. China’s Experiments in Building a Personal Bankruptcy System

On March 1, 2021, the Regulations of Shenzhen Special Economic Zone on Personal Bankruptcy officially came into effect. On the same day, the Shenzhen Bankruptcy Affairs Management Office, which is responsible for personal bankruptcy matters, was established, and the country’s first comprehensive personal bankruptcy application system, “Shen·PoJian” [11], was launched by the Shenzhen Intermediate People’s Court. Shenzhen played a pioneering role, making breakthroughs in system innovation, supporting system construction, and legislative frameworks. This was not

only Shenzhen's exploration but also China's initial step toward establishing a personal bankruptcy system.

More than four months after the implementation of the Regulations of Shenzhen Special Economic Zone on Personal Bankruptcy, a Shenzhen resident, Mr. Liang, received a ruling from the Shenzhen Intermediate People's Court. Mr. Liang's reorganization plan was approved by the People's Court, and it officially entered the execution stage. This marked the conclusion of China's first-ever personal bankruptcy case, and Mr. Liang became the first individual in the country to undergo personal bankruptcy reorganization. The Shenzhen Intermediate People's Court's ruling in this case has profound significance. In this particular case, the individual was able to achieve their desired outcome, avoiding a prolonged debt burden. The debtor's ability to repay, both objectively and subjectively, was greatly improved. For creditors, it also resolved the issue of "uncollectable debts," preventing situations where debts could not be recovered.

In Jiangsu, with approval from the Supreme People's Court of the People's Republic of China, a pilot program for personal bankruptcy was launched, and its scope is continually expanding within the province. This has provided an opportunity for a number of "honest but unfortunate" debtors to restart their businesses.

From the current design of China's personal bankruptcy system, there is no need to worry that judicial rulings on personal bankruptcy will provide an opportunity for individuals to evade their debts. The Regulations of Shenzhen Special Economic Zone on Personal Bankruptcy have very strict provisions regarding applications and acceptances of personal bankruptcy, and not all debtors can declare bankruptcy. Since the regulations were implemented, out of over 600 applications for personal bankruptcy, only 7 were approved in the first batch, with Mr. Liang being one of them. After submitting the required materials for review, his personal situation, family circumstances, the authenticity of the application materials, willingness to repay debts, and ability to repay the principal were all thoroughly examined, confirming that he met the "honest but unfortunate" criteria.

This demonstrates that, both in theoretical design and practical operation, there are strict procedural regulations and review mechanisms in place to safeguard the personal bankruptcy system. Declaring bankruptcy does not equate to the elimination of existing debts. At the same time, judicial rulings on personal bankruptcy also protect the legitimate rights of creditors. In addition to declaring personal bankruptcy, the People's Court carefully crafted a reorganization plan for Mr. Liang after conducting a thorough investigation. The plan clearly stipulated that, within the next three years, Mr. Liang and his wife would exempt only the necessary living expenses and essential living goods as exempt property, while any other income would be used to repay the debt. If Mr. Liang fails to comply with the reorganization plan, creditors have the right to pursue all unpaid principal and interest. The People's Court's reorganization plan, which carries legal effect and severe consequences for breach of contract, also humanely preserves certain necessary living and production goods for the debtor, allowing the debtor to comply with the reorganization plan to the best of their ability. Compared to traditional debt repayment models, this approach also promotes the efficient realization of creditors' legitimate rights.

4. Prospects for the Development of China's Personal Bankruptcy System

As a new development, the personal bankruptcy system and its supporting measures are not yet perfect at this stage. In the initial design of the system, the review conditions were quite strict to minimize risks and reduce the regulatory pressure on banks. This is evident from the low approval rate of applications, which means that some "honest but unfortunate" individuals are unfortunately excluded. This highlights the need to find a better balance between mitigating potential risks and

meeting practical demands.

In terms of supporting measures, the establishment of the first personal bankruptcy management institution and the launch of the first integrated personal bankruptcy platform are not sufficient to form a complete procedural support system. The People's Courts, credit organizations, banks, credit bureaus, and other stakeholders need to strengthen cooperation and coordination to further streamline application channels and optimize review procedures, ensuring that the personal bankruptcy system operates in a scientific, efficient, and stable manner.

In the long run, the personal bankruptcy system will require legislative support from the national. After all, the Regulations of Shenzhen Special Economic Zone on Personal Bankruptcy is merely a local regulation, and there are considerable differences in terms of legislative rank and scope of application compared to national laws.

For individuals and their families suffering from severe financial distress, the ability to discharge certain debts through the personal bankruptcy system provides hope for a return to normal life and production through their own efforts. However, it cannot be ignored that the system involves supporting frameworks such as the improvement of personal credit systems and the commercialization of commercial banks, which still require further development. At the same time, the implementation of the personal bankruptcy system needs support from higher-level laws.

From public aspirations, academic outlooks, legislative pilot projects, to the conclusion of the first case, China is steadily advancing on the path of exploring the personal bankruptcy system. The imperfections at this stage are real, but the future development holds great promise. It is hoped that pilot regions will take advantage of the reform momentum to deepen practical exploration of the personal bankruptcy system, laying a solid foundation for the enactment of national personal bankruptcy law, sparking more ideas, and allowing more "honest but unfortunate" individuals to shed their burdens and move forward. This will help creditors affected by debt issues receive what they are owed, promoting the healthy development of the Chinese market economy and achieving new growth.

5. Conclusion

In conclusion, the establishment of the personal bankruptcy system in China marks a significant step towards addressing the legal and financial challenges faced by individuals in debt. Shenzhen's pioneering efforts provide a valuable foundation for the development of a nationwide system, demonstrating the potential benefits for both debtors and creditors. While the current system is still evolving, it has proven to be an essential tool in ensuring fair debt repayment, protecting basic living standards, and aligning China's legal framework with international norms. As China continues to refine its personal bankruptcy system, the country can look forward to a more balanced and resilient economic environment, offering individuals a fair chance at financial recovery while safeguarding creditors' interests. The future of personal bankruptcy in China holds great promise for both economic growth and social stability.

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