



HAN KUN LAW OFFICES

# Legal Commentary



CHINA PRACTICE • GLOBAL VISION

January 8, 2018

## Banking & Finance Law

### CBRC Bringing Trust Services Back to Basics?

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The Central Economic Working Conference, held in December 2017, recognized that the prevention and control of financial risks are vital in the battle to prevent and resolve major risks, and requested financial services to be the main focus of supply-side structural reforms in order to form a virtuous cycle between the financial industry and the real economy, the financial industry and the real estate sector, as well as within the financial system. Subsequently, the China Banking Regulatory Commission ("**CBRC**") on 22 December 2017 issued the *Circular on Regulating Bank-Trust Business* (the "**Circular**")<sup>1</sup> which is intended to streamline business co-operation between commercial banks and trust companies (the "**Bank-Trust Business**"), and particularly the so-called "channel business" between them (the "**Bank-Trust Channel Business**").

How does the Bank-Trust Channel Business relate to the basic trust concepts under the PRC Trust Law? This newsletter begins with the newly-promulgated regulatory requirements under the Circular and briefly analyzes the regulatory trends of the Bank-Trust Business, particularly the Bank-Trust Channel Business, in the context of the current phase of the trust industry.

#### De-channelization is an Inevitable Trend

According to the China Trustee Association, as of 2017 Q3, the total balance of trust assets in China was RMB24.41 trillion, an increase of RMB1.27 trillion from 2017 Q2 (i.e., RMB23.14 trillion). The year-on-year growth rate in 2017 Q3 reached 34.33% and the month-on-month

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<sup>1</sup> 《中国银监会关于规范银信类业务的通知》[Circular of the China Banking Regulatory Commission on Regulating Bank-Trust Business] (China Banking Reg. Comm., Yin Jian Fa [2017] No. 55; issued 22 Nov. 2017), available at [http://www.cbrc.gov.cn/chinese/home/docDOC\\_ReadView/656ED8C75FA44F0387EF393B842A8A11.html](http://www.cbrc.gov.cn/chinese/home/docDOC_ReadView/656ED8C75FA44F0387EF393B842A8A11.html) (Chinese).

growth rate was 5.47%. Among these growth figures, the balance of the channel trust business increased from RMB12.48 trillion (2017 Q2) to RMB13.58 trillion (2017 Q3), and the corresponding proportion of channel trust business assets increased from 53.92% (2017 Q2) to 55.66% (2017 Q3). Since 2013, the channel trust business has grown at a rapid pace and has exceeded 50% of all trust assets as of 2017 Q3.<sup>2</sup> The rapid expansion of the channel trust business has resulted in a gradual increase in underlying risks and has thus attracted the attention of the regulator.

## **The Position of the Bank-Trust Business and Bank-Trust Channel Business**

Bank-Trust Business was born with the RMB 4 trillion fiscal stimulus package designed to counteract the 2008 financial crisis. CBRC facilitated the issuance of loans by permitting trust companies to channel loan funds through "bank-trust co-operations" (the original funds were collected from bank wealth management products). During the period from 2008 to 2010, CBRC issued the *Guidelines on Business Cooperation between Banks and Trust Companies*,<sup>3</sup> the *Notice of the China Banking Regulatory Commission on Further Regulating Matters Concerning Cooperation between Banks and Trust Companies*,<sup>4</sup> and the *Notice on Regulating Relevant Matters on Wealth Management Cooperation between Banks and Trust Companies*.<sup>5</sup> In these documents, CBRC has defined "wealth management (business) co-operation between banks and trust companies" as "an activity where a bank entrusts capital collected from wealth management products to trust companies, which shall manage, utilize and dispose of such capital as trustees according to agreed trust documents."<sup>6</sup> Meanwhile, CBRC also clarified that, during such bank-trust co-operation, "a trust company shall observe the principle of self-management, strictly perform the duties of choosing projects, conducting due diligence, making investment decisions, and conducting post management; in this case, no channel business is permitted for the bank-trust co-operation" (underline added).<sup>7</sup> Such provisions are

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<sup>2</sup> See China Trustee Assoc., *Comments on the Development of China's Trust Industry in the Third Quarter of 2017*, (8 Dec. 2017), available at <http://www.txh.net/txh/statistics/43707.htm> (Chinese).

<sup>3</sup> 《银行与信托公司业务合作指引》[Guidelines on Business Cooperation between Banks and Trust Companies] (China Banking Reg. Comm., Yin Jian Fa [2008] No. 83; issued 4 Dec. 2008), available at [http://www.cbrc.gov.cn/chinese/home/docDOC\\_ReadView/20081222D75C0AA1792B5FBBFFC19BF9CCD\\_B9000.html](http://www.cbrc.gov.cn/chinese/home/docDOC_ReadView/20081222D75C0AA1792B5FBBFFC19BF9CCD_B9000.html) (Chinese).

<sup>4</sup> 《中国银监会关于进一步规范银信合作有关事项的通知》[Notice of the China Banking Regulatory Commission on Further Regulating Matters Concerning Cooperation between Banks and Trust Companies] (China Banking Reg. Comm., Yin Jian Fa [2009] No. 111; promulgated 14 Dec. 2009), available at [http://www.cbrc.gov.cn/govView\\_F0BF92FE32814EF3A0614803E0D33367.html](http://www.cbrc.gov.cn/govView_F0BF92FE32814EF3A0614803E0D33367.html) (Chinese).

<sup>5</sup> 《中国银监会关于规范银信理财合作业务有关事项的通知》[Notice on Regulating Relevant Matters on Wealth Management Cooperation between Banks and Trust Companies] (China Banking Reg. Comm., Yin Jian Fa [2010] No. 72; promulgated 5 Aug. 2010), available at [http://www.cbrc.gov.cn/govView\\_24263283F98D4F32AAD4AD0A9C66A2B2.html](http://www.cbrc.gov.cn/govView_24263283F98D4F32AAD4AD0A9C66A2B2.html) (Chinese).

<sup>6</sup> See Guidelines on Business Cooperation between Banks and Trust Companies, Art. 2; Notice of the China Banking Regulatory Commission on Further Regulating Matters Concerning Cooperation between Banks and Trust Companies, Art. 1.

<sup>7</sup> Notice on Regulating Relevant Matters on Wealth Management Cooperation between Banks and Trust Companies, Art. 2.

in line with trust concepts under the PRC Trust Law, which provides that trustees are to provide asset management as authorized by and on behalf of their clients.

The definition of "cross-industry channel business" first appeared in the *Guidelines for the Consolidated Management and Supervision of Commercial Banks* in 2014,<sup>8</sup> which provides that "cross-industry channel business refers to transaction arrangements whereby a commercial bank or an affiliate inside a bank group, as a client, uses internal or outside third-party institutions, such as securities companies, trust companies or insurance companies, as a channel to establish a single-layer or multi-layer asset management plan, trust plan or other investment product with funds from wealth management products, entrustment loans or its own funds so as to raise funds or invest in other assets for the target customers of the client." Meanwhile, the Guidelines expressly stipulate that, when engaging in cross-industry channel business, the client must assume the credit risk, liquidity risk and market risk arising from these activities.

Although CBRC has recognized the general existence of the Bank-Trust Channel Business in its various notices in recent years, and has required that the financial institutions engaging in cross-product or co-operative business clarify the risk allocation mechanism in written contracts (i.e., to identify the party to assume legal risk and the party merely serving as the channel),<sup>9</sup> there was no official definition of "Bank-Trust Channel Business" prior to the promulgation of the Circular. The Circular for the first time incorporates into the scope of the Bank-Trust Business both the on-balance-sheet and off-balance-sheet capital of banks and the right to receivables, which serves to further confirm that the Bank-Trust Channel Business is an activity whereby "a commercial bank (as an originator) establishes a monetary or a property right in trust and the trust company only serves as a channel; the management, utilization and disposal of such trust funds or trust assets are all decided by the originator and the risk management

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<sup>8</sup> 《商业银行并表管理与监管指引》[Guidelines for the Consolidated Management and Supervision of Commercial Banks] (China Banking Reg. Comm., Yin Jian Fa [2014] No. 54; promulgated 30 Dec. 2014), available at: <http://www.cbrc.gov.cn/chinese/home/docView/27E97E0235134CBDBD5AD4F5AD0A4D42.html> (Chinese).

<sup>9</sup> In 2013, the General Office of the State Council issued the *Notice on Issues concerning Strengthening the Supervision of Shadow Banking* (Guo Ban Fa [2013] No. 107) and on 8 April 2014, the General Office of CBRC issued the *Guiding Opinions on the Risk Supervision of Trust Companies* (Yin Jian Fa [2014] No. 99), both of which require that, for cross-products and cooperative business between financial institutions, the party assuming risks and liabilities in a transaction or arrangement must be specified in the form of a contract, and the industry regulator of the parties assuming risks is responsible for supervision and administration. On 28 March 2017, the General Office of CBRC issued the *Notice on Special Inspection of Regulatory Arbitrage, Idle Arbitrage and Related Arbitrage in the Banking Industry*, whereby the banking financial institutions were requested to summarize information on channel business and assume risk management responsibilities for the asset management products invested with banks' funds. Risk management duties, such as due diligence, risk review and post inspections cannot be assigned to institutions only providing channel services. In addition, in a notice issued by the General Office of the China Banking Regulatory Commission on 6 April 2017, the *Notice on Carrying out the Special Campaign against "Inappropriate Innovations, Inappropriate Transactions, Inappropriate Incentives, and Inappropriate Collections of Fees" in the Banking Industry* (Yin Jian Ban Fa [2017] No. 53), the regulator cites as an inappropriate transaction the case where the parties failed to specify the risk management responsibilities of all participants in a Bank-Trust Business arrangement, which may lead to investor complaints or legal disputes.

responsibilities and risk of loss resulting from improper management shall be entirely borne by the originator." This clarified definition explicitly assigns the risks and liabilities among the parties involved in the Bank-Trust Channel Business arrangements and provides instructive guidelines for disputes that arise from bank-trust co-operations, since banks generally hold a stronger market position than trust companies and it is often difficult to attribute liabilities in case of a failure of the co-operation.

### **Regulation of Banks and Trust Companies**

The Circular sets forth specific requirements for banks and trust companies engaging in the Bank-Trust Business (particularly the Bank-Trust Channel Business):

For banks, the Circular requires that the Bank-Trust Business is to be regulated under the principle of "substance over form," regardless of whether it is a channel business or not; banks are required to set aside capital and reserves according to substantive credit risks, regardless of whether the arrangement is on- or off-balance-sheet. With respect to the Bank-Trust Channel Business, the Circular further requires banks (i) to monitor risk based on business substance, (ii) not use trust channels to conceal risks or to circumvent prohibitive regulations on use of funds, classification of assets, reserve provisions and capital occupation, and (iii) not to falsely take advantage of channels to place assets off-balance sheet. Meanwhile, commercial banks are required to manage counterparties (i.e., the trust companies) through a name-list system, where the risk management and investment capacity of these trust companies is to be carefully evaluated.

For trust companies, the Circular requires that trust companies not i) accept guarantees directly or indirectly from banks (as originators); (ii) enter into under-the-table agreements with banks; (iii) circumvent regulatory requirements for banks or unlawfully provide channel services to third parties; or (iv) channel trust capital to restricted or prohibited industries such as real estate, local financing platforms, the stock market or other sectors with excess production capacity.

### **Bank-Trust Channel Business vs. Basic Concept of Trusts**

In the Circular, CBRC emphasizes that trust companies, rather than blindly pursuing scale and speed, should actively transform their growth models by exploiting their strengths as professional trustees, provide professional trust services to the banks in substance, and support the development of the real economy based on trust concepts.

However, how the Bank-Trust Channel Business connects with the basic trust concepts in the PRC Trust Law is an issue worth noting. According to the PRC Trust law, a trustee must manage and dispose of trust assets under its own name, even if the trustee may appoint a third party to handle trust matters pursuant to a special arrangement in the trust documents, the

trustee will be responsible for trust affairs managed by the third party. There is a similar provision under the *Measures for Administration of Trust Companies* (the "**Trust Company Measures**"),<sup>10</sup> which provides that trust companies are required to handle trust matters themselves. Where there are different arrangements under the trust documents, the trust company may in certain cases appoint a third party to handle matters on its behalf, but the trust company is still obliged to undertake supervisory obligations and assume all liabilities for the trust matters so handled by the third party. As a result, if the rules under the PRC Trust Law and the Trust Company Measures apply, trust companies may still be liable under the Bank-Trust Channel Business arrangements, even if the management responsibilities have been expressly assigned to the originator (or its third party designee) in the trust documents and the risk/liability allocation is explicitly pre-agreed in the trust document.

### **Regulatory Outlook**

The regulatory trend of de-channelization is quite clear, and it may undergo a long process. The Circular states that CBRC will further study and clarify the regulatory measures on the channel business of trust companies, and CBRC will hopefully clarify in future regulations how channel trust business may fit into the basic trust concepts under the PRC Trust Law and the Trust Company Measures.

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<sup>10</sup> See 《信托公司管理办法》 [Measures for Administration of Trust Companies] (China Banking Reg. Comm., Decree [2007] No. 2; promulgated 23 Jan. 2007, effective 1 Mar. 2007).

## ● **Important Announcement**

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