

# MODERNIZING CHINESE TRUST LAW

STEPHEN TENSMEYER\*

*There are important uses for trusts that are essentially unavailable in China. Family trusts and larger-scale trusts run by private parties for the public interest are extremely rare and face a difficult regulatory environment. While China's Trust Law itself recognizes a distinction between "civil" and "commercial" trusts, the regulations governing trust businesses recognize no such distinction. These regulations impose conditions that make small-scale family trusts and collective civil trusts almost impossible. It is unclear whether these regulations apply to all trusts, but even if they do not, the narrow view of trusts that they promote limits the usefulness of trusts in other areas. However, these types of trusts could be accommodated by easy reforms revising the regulatory and legal framework to permit and facilitate family and public interest trusts.*

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INTRODUCTION

Wang Wenwen<sup>1</sup> lives in Hebei province outside Beijing. She is a tireless advocate who has devoted the past decade to motivating both civil society and government to help disabled people throughout China. She has worked with disabled persons’ federations across the country and has been a great help to some of the most disadvantaged members of Chinese society. But far from being simply an ideological crusader, she is an activist mostly out of desperation: Mrs. Wang’s two daughters both have cerebral palsy and require constant care, and as both mother and children age, she is less and less able to keep up with their needs.

Most of all, she is worried about what will happen after she dies. To help her plan for her daughters’ care, Mrs. Wang turned to the Disability Law Clinic at Renmin University in Beijing and to Attorney Zhang Wenjuan, the Deputy Director of Beijing Children’s Legal Aid and Research Center at Zhicheng Public Interest Lawyers. The students of the clinic—including Du Hanyi, Xia Qingan, and Zhang Dinglin—investigated several options that were used in the United States and determined that a private family trust with a close relative acting as trustee would perfectly suit Mrs. Wang’s needs. However, after further research, it became clear that creating an American-style trust in China would be anything but simple. Chinese trust law and the regulations supplementing it simply were not designed to accommodate such private trusts. In the end, the legal uncertainty surrounding trusts posed too much of a risk for Mrs. Wang to feel comfortable betting her life savings in one. As is common in modern China, an innovation emerged out of civil society, took a few halting steps, and quickly hit a regulatory wall. This Note aims to draw attention to this deficiency in current law and show how it can be corrected.

Understanding the obstacles in Chinese law requires first understanding the concept of trusts. Trusts have been called the greatest single innovation of the English common law.<sup>2</sup> Although this is probably an overstatement, trusts do neatly represent the common law, bearing many of its characteristic strengths and weaknesses. On the

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<sup>1</sup> Name has been changed.

<sup>2</sup> See, e.g., FREDERICK W. MAITLAND, *STATE, TRUST AND CORPORATION* 52 (David Runciman & Magnus Ryan eds., 2003) (“If we were asked what is the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence I cannot think that we should have any better answer to give than this, namely, the development from century to century of the trust idea.”).

one hand, trusts are flexible, practical, and constantly evolving. On the other hand, they are complicated, jargon-filled, and burdened by history. These features make an international comparison of trust systems both fascinating and frustrating. Because they are so flexible, trusts can easily be adapted to local circumstances and used for a wide variety of purposes. But at the extreme, this flexibility means that the very concept of a trust becomes fluid, and transnational conversations about the concept may be more confusing than illuminating.

China is a paradigm example of this trend. The history of trust law in China shows that even a communist society can have a use for a legal tool originally designed to protect landed gentlemen from an overweening government.<sup>3</sup> Beyond the name, however, there is very little that an English landowner from either the seventeenth or twenty-first centuries would recognize in Chinese trust law. But despite these stark differences, analyzing Chinese trust law and comparing it to the common-law system is surprisingly fruitful. Confusions between Chinese and common-law trusts do more than frustrate fussy academics. Careless mixing of legal concepts can often have disastrous consequences for real people like Mrs. Wang and others who are trying to find ways to care for sick and disabled family members.

The problem in China is that the government has designed regulations for sophisticated financial institutions that provide investment funds known as “trusts,” and yet these regulations may apply to many other arrangements that fall under the name “trust,” or in Chinese, 信托 (xintuo). Thus, many useful types of trusts, including the type that Mrs. Wang sought to set up to care for her children, may not be protected under Chinese law because they were not prevalent enough in China to be taken into account when designing regulations. Although the Trust Law itself recognizes a distinction between “civil” and “commercial” trusts,<sup>4</sup> the China Banking Regulatory Commission (CBRC) regulations, which were promulgated to enforce and clarify the Trust Law, recognize no such distinction and so may apply almost across the board.<sup>5</sup> These regulations were designed with large-scale investment trusts in mind and stringently restrict how the trust is established and operated.<sup>6</sup>

This Note will argue that this regime of laws and regulations makes the status of small-scale, civil trusts uncertain in China. Even if there is a principled distinction between civil and commercial trusts, operationalizing this distinction is essentially a no-win situation. If

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<sup>3</sup> See *infra* note 10 and accompanying text.

<sup>4</sup> See *infra* note 100 and accompanying text.

<sup>5</sup> See *infra* Part II.B.

<sup>6</sup> See *infra* Part II.

civil trusts are defined too broadly, such trusts will fall under the rigid CBRC regulations and thus be available only to the wealthiest and most sophisticated investors. If they are defined narrowly to avoid these regulations, however, many useful forms will be left out.

This analysis leads to several suggestions for reform. Since the difficulties come primarily from confusion of concepts, implementing the solutions should not be difficult. At the very least, such reforms would include making explicit exceptions for small-scale civil trusts within the CBRC regulations. A more comprehensive solution could involve new and amended legislation as well as regulations tailored to facilitating civil trusts. Part I gives a brief history of trusts in the common-law system and a more detailed account of their history in China. Part II looks in greater detail at the legal structure of Chinese trusts as determined by the Trust Law and subsequent regulations. Part III investigates the possibility of family trusts and collective trusts for disabled beneficiaries. Finally, Part IV suggests reforms.

## I

### THE HISTORY OF CHINESE TRUSTS

As discussed above, family and other trusts rest on uncertain legal foundations in large part because Chinese law and practice has a conception of the role of trusts very different from the traditional Anglo-American conception. The history of trusts in China shows how China's concept of trusts came to be so different from that of the Western world and lays the foundation for a critical examination of the nature and ramifications of these differences.

#### A. *The Origin of Trusts*

Trusts in England were made possible because of the distinction between courts of common law and courts of equity. The rules of common law were more strict and defined through centuries of precedent.<sup>7</sup> Rules of equity, however, were meant to enforce fairness without regard to the sometimes unduly formalistic rules of law.<sup>8</sup> It was precisely this disjunction that led to trusts; the dual jurisdiction meant that even if someone legally owned a piece of property, a court of equity could find that morality required it to be used for the benefit of another.<sup>9</sup> In the late Middle Ages, wealthy landowners began to use

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<sup>7</sup> See SCOTT ATKINS, *EQUITY AND TRUSTS* 6 (2013) (describing the strict requirements of the common law courts' writ system).

<sup>8</sup> See generally THEODORE F.T. PLUCKNETT, *A CONCISE HISTORY OF THE COMMON LAW* 675–84 (5th ed. 1956) (describing the early history of courts of equity).

<sup>9</sup> DUKEMINIER ET AL., *supra* note 3, at 287–88. According to the law, any piece of land had an absolute owner; when the seller transferred seisin by the ceremonial transfer of a

this system as a tax dodge. Rather than purchasing ownership rights to property, savvy taxpayers would acquire only “use” rights.<sup>10</sup> These so-called “passive uses” constituted ownership in everything but name, but that was enough to avoid taxes on property ownership.<sup>11</sup> In order to stop this practice, the 1535 Statute of Uses dictated that if the owner of the use rights had total control over the property, he would be considered its legal owner and thus subject to taxes.<sup>12</sup> This sharply curtailed passive uses. However, the statute was read to dictate that if the legal owner actually managed the property, ownership would not shift.<sup>13</sup> Uses meeting this requirement were called “active uses” because the legal owner took on active duties in managing the property.<sup>14</sup> This led to the trust system that we have today. The trust’s creator, now called a settlor,<sup>15</sup> designates a legal owner, now called a trustee, who manages the property for the sole interest of the owner of the use, now called the beneficiary.<sup>16</sup>

### B. Trusts in China Before 2001

In contrast to the long history of trusts in England, China had almost no financial arrangements called “trusts” until the late twen-

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stick or dirt clod, the transferee became the absolute owner with no conditions or limitations on his ownership. Courts of equity, however, were “concerned with conscience, not seisin,” and therefore enforced whatever they thought was moral. *See id.* (explaining in greater detail the difference in function and attitude between courts of law and courts of equity).

<sup>10</sup> *Id.* at 288 n.7. Uses were so called because ownership of land could be given to one person while the “use” of the land could be given to another. A “use” would be created if someone granted “to A for the use of B.” A owned the land, but a court of equity would require A to use the land for B’s benefit. *Id.* at 287–88.

<sup>11</sup> Taxes for land were applied to every transfer of seisin. However, a change in the use of land involved no such tax. A landholder could therefore transfer land tax-free by merely transferring the use or the person designated as having the right to use the land. In the extreme, seisin could be granted to an abstract legal entity or to a group of people who were continually replenished. Thus seisin would never transfer, and the tax would never be applied. *Id.* at 288 n.7.

<sup>12</sup> *Id.* at 289–90. The Plantagenet kings (1126–1485) had known full well that this tax evasion was occurring, but only with the Tudor dynasty did the monarchy feel strong enough to put a stop to it. Henry VIII managed to force Parliament to pass the Statute of Uses in 1535. This law “executed” all passive uses, meaning that seisin would attach to whoever had been given the “use” of the land if the holder of seisin had no positive duties. *Id.*

<sup>13</sup> *Id.* at 295 n.9.

<sup>14</sup> *Id.*

<sup>15</sup> BLACK’S LAW DICTIONARY 1582 (10th ed. 2014) (defining “settlor”).

<sup>16</sup> *Id.* at 186 (10th ed. 2014) (defining “beneficiary”). This unique structure, in which the beneficiary has the use of money that technically belongs to someone else, has benefits in areas of tax, debt, and bankruptcy.

tieth century, after the Cultural Revolution.<sup>17</sup> However, trust-like instruments have occasionally been seen throughout Chinese history. There is evidence of financial arrangements similar to trusts as early as the Yuan Dynasty (1271–1368).<sup>18</sup> More advanced forms occurred in the Qing Dynasty (1644–1911),<sup>19</sup> and by the late Qing entire villages operated under complicated forms of real property ownership that were essentially trusts, with a council of village elders managing land

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<sup>17</sup> The Cultural Revolution, which lasted from 1966 to 1976, was Mao's attempt to consolidate power by "smash[ing] the Chinese state and the Communist party." HENRY A. KISSINGER, *ON CHINA* 192–97 (2011).

<sup>18</sup> In the Yuan dynasty play *The Elder of the Eastern Studio* (Dongtanglao), the playwright, in an attempt to drive the plot, essentially ends up inventing a trust. In the play, a dying merchant gives the wise Mr. Li a contract, which the audience does not see or hear, before devising the rest of his estate to his son. See VALERIE HANSEN, *NEGOTIATING DAILY LIFE IN TRADITIONAL CHINA* 129 (1995) (describing the play). The son turns out to be a prodigal worthy of the New Testament and spends his inheritance in drinking and entertainment, selling all his furniture and even his father's house in order to fund his lifestyle. Finally, after he is reduced to poverty, the wise Mr. Li invites him to a party in which he announces that his estate is not lost after all. As it turns out, the contract that the merchant had written stated, "Today, I, Zhao Guoqi, . . . secretly place 500 ingots of silver in the care of my old friend to give to my son . . . to use when he has difficulties and is in need of money." *Id.* at 130. Mr. Li faithfully discharged this duty; every time the son sold off a piece of his estate, Mr. Li would buy it back with the silver he had been given. Mr. Li exercised discretion over the property, but he used it in all cases for the benefit of the son. The play ends happily, with the son's fortune being restored to him. This play has been recognized as containing an unusual contract, but it is more than this; the contract is essentially a trust. Mr. Li has been given money that he can use only for the benefit of his friend's son. Though this is a striking early example of a trust, it is perhaps the exception that proves the rule. Yuan dynasty plays often contained such twist endings, and the surprise depended on the contract being an unconventional one. See *id.* ("This remarkable contract is not a loan to his friend, which would be usual, but a request to safeguard money until his son needs it."). This play seems to show that a trust, while uncommon enough to surprise an audience, was not so far out of bounds as to be seen as an illegitimate contract.

<sup>19</sup> Trusts or trust-like forms of contract are not mentioned in any of the Chinese dynastic codes. However, this does not mean that they did not exist. Dynastic codes covered primarily criminal matters; civil and contractual matters were rarely mentioned, and never in much detail. Neither are trusts mentioned in the extant litigation records from the Qing dynasty. Trust-like forms do, however, make another appearance in the Qing. As early as the seventeenth century, many families in southern China had devised a system of "set-asides," some of which were similar to trusts. DAVID WAKEFIELD, *FENJIA: HOUSEHOLD DIVISION AND INHERITANCE IN QING AND REPUBLICAN CHINA* 173 (1998). For example, a dying landholder would often provide in his will not only for his children, but would stipulate that some money had to be held for the firstborn grandson. *Id.* at 157. This meant holding land in trust—in the Anglo-American sense—until the child reached maturity, or perhaps even holding land for a beneficiary who had not yet been born. See *id.* at 158 (describing a trust providing as follows: "Eldest grandson's share of the property, as witnessed by many relatives, will temporarily go to Yuncheng to manage, and it must not be embezzled. After Chuansheng is grown and married, the property from the division will be returned to him." (internal quotation marks omitted)).

for the benefit of the entire village.<sup>20</sup> These systems were hardy, persisting in some cases even after the Communist revolution.<sup>21</sup>

The end of the Qing and the beginning of the Republican period marked not only the high point of these trust forms, but also the point at which the Western concept of trusts was first introduced to China. Trusts first came by that name to Asia through Japan, which used them to acquire foreign capital for industrial development.<sup>22</sup> The fact that this first use of the trust was simply to raise capital has had an enormous effect on the law of trusts throughout Asia. The first use of Western trusts in China followed this same form; the Republican government tried to raise foreign capital through a similar bond offering in the 1920s.<sup>23</sup> However, despite these measures, Republican China had no law governing trusts.<sup>24</sup>

Although few trusts were used to support the war against Japan, the Chinese government used trusts to attract foreign capital even after the Communist revolution. In fact, in November of 1949, the month after the revolution, the new government's central bank set up a trust division in its Shanghai branch.<sup>25</sup> This was followed by similar "investment companies" in the city of Tianjin in 1951 and in

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<sup>20</sup> In North China, Taiwan, Fujian, and the lower Yangtze delta, families used such trusts systematically to prevent land from being inefficiently subdivided. *See id.* at 186, 198–99 (describing the "downward mobility caused by household division"). In these areas, many patriarchs put a great deal of their land in what were essentially trusts rather than devise it directly to their children. *See id.* 198–99 (describing the shift to using trusts and the benefits thereof). Clan elders would own the land, which would be managed and farmed for the good of the entire clan. These patriarchs could also devote the land to other purposes, including religious and educational uses. *See id.* at 193 (noting the multiple uses of ancestral land trusts, including religious, administrative, and educational trusts). And this structure was extremely common. A study by none other than the young Mao Zedong found that even as late as 1930, "fully 40 percent of the land in the area was in trusts, with ancestral trusts making up 60 percent of that total, religious trusts 20 percent, administrative and educational trusts 20 percent, and public works trusts 10 percent." *Id.*

<sup>21</sup> *See, e.g.,* WAKEFIELD, *supra* note 19, at 193–96 (describing the trust system prevailing in Fujian in 1951).

<sup>22</sup> Makoto Arai, *The Law of Trusts and the Development of Trust Business in Japan*, in MODERN INTERNATIONAL DEVELOPMENTS IN TRUST LAW 63, 66 (David Hayton ed., 1999).

<sup>23</sup> Lusina Ho et al., *Trust Law in China: A Critical Evaluation of Its Conceptual Foundation*, in TRUST LAW IN ASIAN CIVIL LAW JURISDICTIONS 81 (Lusina Ho et al. eds., 2013).

<sup>24</sup> *See id.* (noting that the first trust law was enacted in response to the previous unregulated usage of trusts). This was not unusual. Japan issued bonds under the trust form seventeen years before it passed its first trust law in 1922. *See Arai, supra* note 22, at 66 (noting that the Trust Act and the Trust Business Act, which attempted to adapt the laws of the United Kingdom, India, the United States, and the state of California to the structure of the German Civil Code, were passed simultaneously in that year).

<sup>25</sup> *Zhongguo Xintuo Ye Fazhan de Lishi Mailuo (Overall History of the Development of the Chinese Trust Industry)*, INVESTIDE, <http://www.investide.cn/news/108540.html> (last visited Jan. 10, 2014).

Guangdong Province in 1955.<sup>26</sup> By 1956, however, the country's "socialist transformation" had put a stop to the trust industry.<sup>27</sup> Essentially no change was made until 1979, three years after Mao's death and the beginning of Deng Xiaoping's reform and opening-up policy.<sup>28</sup> In October 1979, the China International Trust & Investment Co. (CITIC), still China's largest trust company, was founded.<sup>29</sup> The trust form was exempt from many regulatory restrictions,<sup>30</sup> and in the laissez-faire environment that prevailed in some Chinese cities after 1979, the number of trust and investment companies exploded. By 1992, there were 1000 of these companies in China.<sup>31</sup> During this period, these companies were most commonly used to bring in foreign capital by acting as both the foreign and the domestic partner in investment transactions.<sup>32</sup> However, the bubble eventually burst and many of these trust companies went bankrupt or became dangerously leveraged, to the point that the industry as a whole had a debt burden between \$12 billion and \$20 billion in 2000.<sup>33</sup>

### C. *Trusts in China Since 2001*

Partly as a reaction to this crisis, the National People's Congress finally passed the Trust Law of the People's Republic of China in 2001.<sup>34</sup> The trust industry was out of control, and particularly considering the companies' desire to create new collective investment funds, the government recognized that some sort of legal framework was

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<sup>26</sup> *Id.*; *Zhongguo Xintuo Ye de Jidang Bainian (The Surging Century of the Chinese Trust Industry)*, CHINA TRUST INDUSTRY DEVELOPMENT REPORT, <http://www.licai.com/xintuo/201407/60118.html> (last visited Jan. 10, 2014) (Guangdong).

<sup>27</sup> *Zhongguo Xintuo Ye Fazhan de Lishi Mailuo (Overall History of the Development of the Chinese Trust Industry)*, *supra* note 25.

<sup>28</sup> *Id.*

<sup>29</sup> KPMG, MAINLAND CHINA TRUST SURVEY 2012, at 32 (2012), available at <https://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Documents/China-Trust-Survey-2012-201207-v2.pdf>. CITIC is not only the largest trust company, but recently has been one of the fastest growing. From 2010 to 2011, the bank's commission income alone increased by eighty-three percent. *Id.*

<sup>30</sup> *See id.* ("Without the same level of regulatory constraint placed on other players in the financial sector, trust companies thrived.")

<sup>31</sup> *Id.*

<sup>32</sup> *See id.* (explaining that the trust companies' "most common function was lending to construction subsidiaries in which the trust and investment company (TIC), as trust companies were known back then, would play the dual role of both the overseas and domestic partner").

<sup>33</sup> *Id.* at 33.

<sup>34</sup> *Zhonghua Renmin Gongheguo Xintuofa (中华人民共和国信托法)* [Trust Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Apr. 28, 2001, effective Oct. 1, 2001), 2001 STANDING COMM. NAT'L PEOPLE'S CONG. GAZ., available at [http://www.gov.cn/gongbao/content/2001/content\\_60870.htm](http://www.gov.cn/gongbao/content/2001/content_60870.htm) [hereinafter Trust Law].

imperative.<sup>35</sup> The commercial needs of the trust industry were paramount in this development; as one group of scholars has noted, “[t]here was very little, if any, demand from the local population to enact the law for use in family succession and wealth planning, let alone for public or charitable purposes.”<sup>36</sup> The trust law was modeled in part after Taiwan’s trust law.<sup>37</sup> Most simply, the law defines a trust, explains how it can be created, describes what kind of property can be subject to it, and outlines the rights and responsibilities of the principal actors: the settlor, the trustee, and the beneficiary.<sup>38</sup> But beyond these basic provisions, the law itself is somewhat vague, and perhaps as a result, it did not on its own change the trust industry in any fundamental way. In fact, perhaps the most important provisions in the law were those stating that the trust industry was subject to future administrative regulation.<sup>39</sup> However, it was to be several years before any regulations were adopted.

In March 2007, the CBRC issued two regulations that had an enormous practical effect on the trust industry. The first were the Rules Governing Trust Companies.<sup>40</sup> These regulations set the trust industry on a new footing after the uncontrolled growth and collapse of the previous three decades.<sup>41</sup> The regulations designated the CBRC as the administrative overseer of the industry<sup>42</sup> and established leverage limits: Trust companies were forbidden to hold debt greater than twenty percent of their net assets.<sup>43</sup> They also restricted the types of foreign exchange in which trust companies could participate,<sup>44</sup> imposed registration requirements,<sup>45</sup> ordered that trust companies

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<sup>35</sup> Ho et al., *supra* note 23, at 81.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.* at 82. This was the first trust law in the history of the Republic of China, which, as mentioned above, had no trust law even when it was the government of mainland China.

<sup>38</sup> See *infra* Part II.A (discussing the Trust Law).

<sup>39</sup> Trust Law, *supra* note 34, art. 24 (“Where there are other provisions governing qualifications of a trustee laid down in laws or administrative regulations, those provisions shall prevail.”).

<sup>40</sup> Xintuo Gongsì Guanli Banfa (信托公司管理办法) [Rules Governing Trust Companies] (promulgated by the China Banking Reg. Comm’n, Dec. 28, 2006, effective Mar. 1, 2007) [hereinafter Rules Governing Trust Companies], available at <http://www.cbrc.gov.cn/chinese/home/docView/2007020146C75FE4EC42DAA9FFADADCB71D8A300.html>.

<sup>41</sup> See KPMG, *supra* note 29, at 32 (noting that the measures sought to “clarify the future development of the sector” after decades of “unruly expansion”).

<sup>42</sup> The CBRC has been extremely vigilant in this role. In 2011 alone, it issued 36 rules and notices affecting the trust industry. KPMG, *supra* note 29, at 4.

<sup>43</sup> Rules Governing Trust Companies, *supra* note 40, art. 21.

<sup>44</sup> *Id.* at art. 16.

<sup>45</sup> *Id.* at arts. 6–12.

follow certain corporate formalities,<sup>46</sup> developed supervisory protocols,<sup>47</sup> and promulgated other measures aimed at reducing investment risk.<sup>48</sup> Trust companies had to achieve compliance with these new regulations within three years in order to qualify for certification.<sup>49</sup>

The year 2007 also saw the announcement of the Rules on Trust Schemes of Collective Funds by Trust Companies.<sup>50</sup> As will be explained further below, these regulations limited the number and type of investors that could invest in a collective fund, placing a threshold on investment capital that made participation in collective trusts impossible for all but the wealthiest individuals or institutional investors. They also regulated investment strategies, imposed disclosure requirements, provided for beneficiary meetings, and mandated the appointment of a competent commercial bank as a custodian for every collective trust fund.<sup>51</sup>

Together, these two rules amounted to a fundamental restructuring of the trust industry, leading to much greater immediate changes than the 2001 Trust Law. Trust companies immediately began restructuring, and the stricter requirements led to a dramatic and likely permanent downshift in the number of trust companies.<sup>52</sup> As of 2011, there were only sixty-six registered trust companies.<sup>53</sup> However, despite—and perhaps because of—the new requirements, the trust industry has grown dramatically, rising from RMB 2.0 trillion assets under management (AUM) in 2009, to RMB 4.8 trillion in 2011, to RMB 8.73 trillion by early 2013.<sup>54</sup> Trusts have grown in nearly all industries.<sup>55</sup> Trust companies have also developed new products to

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<sup>46</sup> *Id.* at arts. 24–41.

<sup>47</sup> *Id.* at arts. 43–47, 50–57.

<sup>48</sup> *Id.* at arts. 48–49.

<sup>49</sup> KPMG, *supra* note 29, at 33.

<sup>50</sup> Xintuo Gongsì Jihe Zìjìn Jìhuà Guānlì Bānfǎ (信托公司集合资金信托计划管理办法) [Rules on Trust Schemes of Collective Funds by Trust Companies] (promulgated by the China Banking Regulatory Comm'n, Dec. 28, 2006, effective Mar. 1, 2007) [hereinafter Rules on Trust Schemes of Collective Funds by Trust Companies], <http://www.cbrc.gov.cn/chinese/home/docView/2007020140E41E8F4749E6F4FF15F12F68C86600.html>.

<sup>51</sup> *See infra* Part II.A.2.

<sup>52</sup> Experts estimate that the number of trust companies will never exceed seventy-two under the current rules. *See* KPMG, *supra* note 29, at 32–33 (discussing the status of trusts after restructuring).

<sup>53</sup> *Id.*

<sup>54</sup> Dinny McMahon, *Trusts Flourishing in China, for Now*, WALL ST. J., May 8, 2013, available at <http://www.wsj.com/articles/SB10001424127887324059704578470672895016066>.

<sup>55</sup> However, the balance has shifted dramatically from Real Estate Investment Trusts and Local Governance Finance Vehicles to mining and commodity trusts. *See* KPMG, *supra* note 29, at 10 (noting that mining and commodity trusts have been the primary beneficiaries as real estate investment has plateaued).

invest in securities, futures, “trusts of trusts,” and even artwork and alcohol.<sup>56</sup>

Since 2007 the industry has grown tremendously. With new regulations such as the 2008 Guidelines on Business Co-operation between Banks and Trust Companies<sup>57</sup> and the 2011 Measures for the Administration of Net Capital of Trust Companies,<sup>58</sup> the CBRC has tried to push trust companies to become active wealth managers rather than merely passive investment vehicles.<sup>59</sup> In the years since these new regulations, most trust companies have been able both to raise new capital and to allocate existing capital more efficiently.<sup>60</sup>

This brief history shows that from the beginning, trusts in China have been driven primarily by commercial needs, particularly by the government’s need for strategic investment. In the same period that the Chinese government was adopting trusts as an investment tool, the

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<sup>56</sup> The *baijiu* (Chinese white wine) trust funds alone were valued at RMB 896 million in 2011. *Id.* at 17. This proliferation of types of trusts may be a bubble preparing to burst. *See* McMahon, *supra* note 54 (noting that “[t]he biggest threat to the trusts could be their own success”; the industry may have reached the saturation point, with most easy investment opportunities having been absorbed already); *see also* Grace Zhu, *China Trust-Sector Growth Slows on Increased Regulation*, WALL ST. J. (Apr. 23, 2014, 2:27 AM), <http://www.wsj.com/articles/SB10001424052702304049904579518793072183178> (describing both the rapid expansion of trust companies and their slowed growth under regulatory supervision).

<sup>57</sup> *Yinhang yu Xintuo Gongsì Yewu Hezuo Zhiyin* (银行与信托公司业务合作指引) [Guidelines on Business Co-operation between Banks and Trust Companies] (promulgated by China Banking Regulatory Comm’n, effective Dec. 4, 2008), [http://www.china.com.cn/policy/txt/2008-12/23/content\\_16992206\\_2.htm](http://www.china.com.cn/policy/txt/2008-12/23/content_16992206_2.htm) (China). These guidelines prohibited certain high-risk products and encouraged more active fund management. *Id.*; *see also* Charles Qin & Tomy Xia, *Guidelines on Business Co-operation between Banks and Trust Companies*, LLINKS FINANCIAL SERVICES BULLETIN, Apr. 2009, available at <http://www.llinks.com/shangchuan/2009416120349.pdf> (identifying provisions of the new guidelines that encourage more active management). In order to reduce risk, the new guidelines gave new balance sheet requirements and limited some activities of bank-trust combinations. *Id.*

<sup>58</sup> These imposed new disclosure requirements and new capital requirements calculated by risk weightings outlined in the rule. KPMG, *supra* note 29, at 4. For risk weighting purposes, trust products are divided into two classes, proprietary investments and entrusted asset investments, and thirty-five categories. These range from a weighting of 0% for cash assets to 9% for “credit asset transfer using bank-trust cooperation products.” *See id.* app. II (giving all weightings). According to these regulations, all trust companies must have a minimum net capital of RMB 200 million and a minimum of forty percent net capital to net assets ratio. *Id.* at 21.

<sup>59</sup> *See* KPMG, *supra* note 29, at 13 (arguing that many regulations issued since 2010 were meant to transform trust companies from passive sellers of products into “professional third party wealth managers”).

<sup>60</sup> New regulations have helped to streamline this process and therefore, far from hindering the growth of the industry, have actually stimulated it. *See id.* at 22 (“By enforcing capital management requirements, the regulator has essentially fast tracked and simplified the application of key performance indicators for trust companies.”).

home-grown trusts were disappearing.<sup>61</sup> Today, the trust industry may be the second largest industry in China's financial services sector.<sup>62</sup> But the vast majority of trusts in China today are trusts in name only. Functionally, they are like any other investment vehicle. However, the CBRC's recent regulations have sought to reorient these trust companies as active wealth managers, which would bring Chinese trusts somewhat closer to the Western conception. Even if such a change were effected, however, trusts would likely remain a tool of institutional investors and a few extremely wealthy individuals.

## II

### ARE FAMILY AND COLLECTIVE NONCOMMERCIAL TRUSTS POSSIBLE IN CHINA?

Although many people, including Wang Wenwen, have considered the possibility of setting up noncommercial trusts, almost none have been set up in China, and the few that do exist rest on dubious legal foundations. Although the 2001 Trust Law allows for such trusts, the 2007 Rules Governing Trust Companies and Rules on Trust Schemes of Collective Funds may inadvertently have made such trusts extremely difficult to establish.<sup>63</sup> These regulations impose strict conditions on who can act as settlor, trustee, and beneficiary of a trust, and, intentionally or not, their scope is likely not limited to commercial trusts. In short, because of inartful drafting, regulations that were primarily intended to impose strict requirements on commercial trusts may apply to *all* trusts, civil or commercial, private or public.

This section will begin by evaluating the limitations on the settlor, trustee, and beneficiary, first under the 2001 Trust Law and then under the 2007 CBRC regulations. This analysis will make clear that if the CBRC regulations apply to all trusts, the establishment of family and other noncommercial trusts becomes virtually impossible. Next, this section will analyze both the Trust Law and the regulations, showing that under the most reasonable interpretation of both, the regulations almost certainly apply to collective noncommercial trusts and may apply to private family trusts. Finally, in light of these limitations, this section will consider the feasibility of family trusts and pooled self-settled trusts, which are collective trusts in which non-

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<sup>61</sup> Cf. *supra* note 36 and accompanying text (discussing how the trust industry's commercial needs were paramount).

<sup>62</sup> See KPMG, *supra* note 29, at 2 (predicting that the trust sector would become the second-largest industry in China's financial services sector by the end of 2012).

<sup>63</sup> See *infra* Part II.C (arguing that the current legal framework creates difficulties for noncommercial trusts).

profit groups act as trustee for individual disabled or elderly beneficiaries.

### A. *Restrictions on Settlor, Trustee, and Beneficiary*

#### 1. *Restrictions Under the Trust Law*

Under the Trust Law, a trust can be created only by a “writing,” which can take the form of a “trust contract[ ], testament, or other document[ ] specified by laws or regulations.”<sup>64</sup> A trust becomes effective upon the formation of the contract and not, as in most other Asian jurisdictions, when the property is transferred from the settlor to the trustee.<sup>65</sup> Additionally, although the law does not impose a stand-alone registration requirement, it states that if other laws or regulations require registration, a trust cannot be effective without such registration.<sup>66</sup>

The law also outlines the duties and rights of the key players: the settlor, the trustee, and the beneficiary. The settlor has almost total control over the form of the trust. The settlor can make the trust revocable or irrevocable, add clauses to the default language, and limit the rights of the trustee or the beneficiary.<sup>67</sup> After the trust is created, however, the settlor’s rights are strictly limited by the terms of the trust itself.<sup>68</sup> Settlers also have the right to review the records of the trust and demand explanations from the trustee during the course of

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<sup>64</sup> Trust Law, *supra* note 34, art. 8. *See also* Ho, *supra* note 23, at 82 (noting that “catch-all” phrases such as “other documents” are common in Chinese law, and that no such documents have yet been authorized).

<sup>65</sup> Ho, *supra* note 23, at 84. This also leaves open the question of whether a settlor who has created a trust but not given his property to the trustee has an obligation to do so. *See id.* (noting that the Trust Law itself puts no such duty on the settlor).

<sup>66</sup> Trust Law, *supra* note 34, art. 10. The law is unclear about whether it is the trust itself, the trust property, or something else that must be registered. Professor Lingyun Gao has argued that this ambiguity is “the most vulnerable point of the Chinese trust system even for the commercial trusts, because there is neither a central registration system nor local systems for trusts to register.” Lingyun Gao, *The Development of Private Trusts in Mainland China: Legal Obstacles and Solutions*, 20 TRUSTS AND TRUSTEES 350, 356 (2014). Although the ambiguity exists as a practical matter, as a matter of statutory interpretation, the question does not seem difficult. The clause simply states that the trust must follow other applicable law. Whether that law requires registration of the trust itself, the property, or something else depends upon that law, not upon any interpretation of the Trust Law itself.

<sup>67</sup> Though the law itself lists several possible clauses that can be added, it implies that any other relevant provision could be added as well. *See* Trust Law, *supra* note 34, art. 9 (“In addition to the items mentioned above, the period of the trust, the methods for the administration of the property under trust, remuneration payable to the trustee, manner for appointing another trustee, the cause for termination of the trust, *etc.* may be stated clearly.” (emphasis added)).

<sup>68</sup> For example, the case of *Yanxin Co. v. Huabao Trust & Investment Co.* held that a settlor cannot assign her rights if doing so would “alter the terms of the trust contract or

management.<sup>69</sup> Perhaps the most important, and certainly the most unusual, right of the settlor is the right to petition a court to set aside a disposition by the trustee that she alleges is in violation of the trust's terms.<sup>70</sup> These rights are especially important because, as discussed further below, essentially all trusts in China designate the settlor as the sole beneficiary.<sup>71</sup> If the settlor is successful in having the disposition set aside, the trustee must rescind the transaction or otherwise "restore the property to its former state."<sup>72</sup> Interestingly, the Trust Law talks only in terms of the settlor's rights: The settlor has essentially no positive duties.

The beneficiary has few default rights to enforce the trustee's fiduciary duties under the Trust Law, although his or her rights may of course be expanded in the trust document. In fact, the only positive right the Trust Law gives to beneficiaries is, ironically, the right to give up one's rights as a beneficiary.<sup>73</sup> A beneficiary can be any legal person, including the settlor or the trustee.<sup>74</sup> However, the trustee, unlike the settlor, cannot be a sole beneficiary.<sup>75</sup> Thus, as with the settlor, there are almost no limitations on who can act as beneficiary.

Perhaps because relief for breach of fiduciary duty is difficult to obtain,<sup>76</sup> under Chinese law trustees are subject to somewhat greater

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augment the duties of the trustee." *Yanxin Co. v. Huabao Trust & Inv. Co.*, (Shanghai Intermediate People's Ct., Mar. 16, 2005), *translated in Ho, supra* note 23, at 83.

<sup>69</sup> Trust Law, *supra* note 34, art. 20. Trustees are also required to submit annual reports of their activities to settlors and beneficiaries. *Id.* art. 33.

<sup>70</sup> *Id.* art. 22.

<sup>71</sup> See *infra* note 91–93 and accompanying text (describing how the settlor acting as beneficiary turns the trust into an ordinary investment vehicle).

<sup>72</sup> Trust Law, *supra* note 34, art. 22.

<sup>73</sup> *Id.* art. 46.

<sup>74</sup> *Id.* art. 43.

<sup>75</sup> *Id.*

<sup>76</sup> The remedies authorized by the Trust Law are different and less numerous than those available in common law jurisdictions. In addition to the petition for rescindment of specific transactions mentioned above, Article 11 outlines six circumstances under which the trust can be voided: 1) if the trust's purposes are illegal or "impair public interest," 2) if the property "cannot be fixed," 3) if the property is contraband or otherwise forbidden to be put in trust, 4) if the trust is created specifically for "taking legal actions or for recovering debts," 5) if the beneficiary cannot be determined, or 6) in other circumstances stated in laws or regulations. *Id.* art. 11. The next article states broadly that a trust can be set aside if it is "to the detriment of the interests of [the settlor's] creditors." This cannot literally be true; essentially all trusts will at least indirectly harm present or future creditors. Though this issue has not been litigated, it seems likely that such a trust would be voided on this basis only if there were additional reasons for suspicion, such as the settlor forming the trust simply to avoid debt payment. However, this provision does offer a broad loophole for courts looking to void a trust on other grounds. This is also true of the stipulation that trusts can be voided for impairing the public interest. This extremely broad catch-all term essentially gives the government power to cancel any trust it doesn't like. For a settlor, however, using this framework of voidability to respond to a breach of trust

restrictions than settlors or beneficiaries. Any “natural person or legal person who has full capability for civil conduct” can act as trustee.<sup>77</sup> Although perhaps no such limitation was intended, this has the effect of preventing groups without legal personhood from acting as trustees. In China, this is not a trivial limitation; it means that “some profit-making enterprises or economic associations, and most profit-making official organs, institutions and social organizations” are forbidden to act as trustees.<sup>78</sup> Trustees are also required to abide by the provisions of the trust document and to act in the best interests of the beneficiaries.<sup>79</sup> In managing the property, a trustee is required to “be careful in performing his duties and fulfill his obligations with honesty, good faith, prudence and efficiency.”<sup>80</sup> Additionally, the law sets up rules that apply when there are multiple trustees and when trustees resign or are removed.<sup>81</sup> Trustees are also forbidden to take any remuneration from the trust if they have negligently caused a loss.<sup>82</sup> The most important duty of trustees, however, is the strict separation of the trust property from the trustee’s personal property.<sup>83</sup> In short,

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would be difficult. But it may not be impossible; for instance, some scholars have suggested that the provisions about illegality could allow a settlor to have the trust set aside for fraud. Hao Wang & Yi Zhou, *China, in THE WORLD TRUST SURVEY* 166 (Charles Gothard & Sanjeev Shah eds., 2010). For ordinary breach of trust, however, there is no set remedy. As a result, a beneficiary or settlor can generally recover only by suing the trustee under contract law or in tort. *Id.* at 164.

<sup>77</sup> Trust Law, *supra* note 34, art. 24.

<sup>78</sup> Ho, *supra* note 23, at 85. As we will see, this and other features of legal and regulatory framework make charitable and public interest trust very difficult, if not impossible, to form and manage.

<sup>79</sup> Trust Law, *supra* note 34, art. 25.

<sup>80</sup> *Id.*

<sup>81</sup> *Id.* arts. 31, 39.

<sup>82</sup> *Id.* art. 36.

<sup>83</sup> *Id.* art. 27. This feature also hints at an important question that is never squarely addressed in the Trust Law: Who actually owns the property after it is put into trust? A Chongqing court has suggested that it does not belong to the trustee. Ho, *supra* note 23, at 88 (citing Beijing Haidian Sci. & Tech. Dev. Co. v. Shenzhen Xinhua Jinyuan Touzi Fazhan Youxian Gongsi, Yugaofa Minchu Zhi [First Instance, Civil Cases, Chongqing High People’s Ct.] Case No. 14 (Chongqing High People’s Ct., Mar. 19, 2007)). Some statements from the Trust Law also support this conclusion: Not only does the law speak often of the trustee’s obligation to keep the property separate from his own property, it also states that “[t]he trustee may not convert the trust property into his own property.” Trust Law, *supra* note 34, art. 27. This passage is not entirely clear, however, especially considering that this official English translation does not entirely reflect the sense of the original Chinese. In the Chinese, the passage says that the trustee cannot turn the trust property into his 固有 (guyou) property. “Guyou” may be translated as “inherent,” but perhaps its true sense can be appreciated most by understanding that it consists of the character 固 (gu) meaning “fixed or firm” and 有 (you), meaning “have.” It is also notably different from the usual word for ownership, 所有 (suoyou). This may in fact suggest the precise opposite meaning than the English; after all, it seems strange to take pains to avoid using the usual word for ownership if the trustee is not the owner in at least some sense. Even if this passage does

unlike the duties of a settlor and of a beneficiary, the duties of a trustee are substantially limited.

This analysis shows that although the actors, especially trustees, sometimes have strictly defined duties, Chinese law places few limitations on *who* can act as a settlor, trustee, or beneficiary. There is no limitation at all on who can act as settlor, while trustees and beneficiaries are required only to be “legal persons.” Although it does unfortunately prevent some very beneficial arrangements, this framework is still quite a liberal one.

It is important to note that although the requirements for settlors, trustees, and beneficiaries apply to most trusts, special provisions apply for what the Trust Law refers to as public welfare or charitable trusts (公益信托). A public welfare trust can be established for many purposes, including poverty relief, promotion of education, disaster aid, and assistance for people with disabilities.<sup>84</sup> The law states that the property in such trusts can be used only for public welfare purposes and must be registered with the public welfare administration authority, which must also approve the choice of trustee.<sup>85</sup> In the few such trusts that have been established, it seems that only local governments have acted as trustees. For example, both Beijing and the province of Guangdong have created trusts to help people with disabilities.<sup>86</sup>

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deny ownership to the trustee, however, it would still be unclear to whom the property belongs as between the settlor and the beneficiary. Zhang Chun, *Xintuo Caichan Dulixing de Fali* [Legal Principles of the Independence of Trust Property] SHEHUI KEXUE [SOCIAL SCIENCES] 102, 102 (2011). Some scholars have argued that the theoretical basis of Japanese law, which also underlies Chinese trust law, suggests that ownership lies with the settlor. However, there is substantial disagreement on this point. Lusina Ho, for example, has compiled authorities supporting five different possibilities: 1) the trustee is the owner, 2) the settlor is the owner, 3) the beneficiary is the owner, 4) nominal ownership transfers to the trustee, but substantive ownership lies with the settlor and beneficiaries, and 5) that ownership goes to whomever the settlor has intentionally transferred it. Ho, *supra* note 23, at 86 n.21. Lingyun Gao, on the other hand, has argued that in drafting the Trust Law, the Chinese legislature purposely left the question open. See Gao, *supra* note 66, at 353 (Because of conflicts between trusts, China’s civil law system, and social environment, the “Chinese legislature decided not to require trust property’s title [to be] transferred into the trust. As a compromise, the 2001 Trust Law neither recognized nor denied title-transfer in creating a trust, therefore title-transfer is not a necessary requirement for people to establish a trust in China.”). This is in stark contrast to the common law regime, which is premised on the idea that legal title can rest in one person, the trustee, while equitable title can rest in another, the beneficiary. See *supra* note 16 and accompanying text (describing the development of the common law system).

<sup>84</sup> Trust Law, *supra* note 34, art. 60.

<sup>85</sup> *Id.* arts. 62, 63.

<sup>86</sup> Cui Hong, Beijing Jiangjian Canjiren Baozhangfang he Canjiren Caichan Xintuo Zhidu (北京将建残疾人保障房和残疾人财产信托制度) [Beijing Will Create a System of Property Trusts and Affordable Housing for the Disabled], Fang.com, Jul. 21, 2011, <http://news.cd.soufun.com/2011-07-21/5479128.htm> (Beijing); Wu Bo, Guangdong Nishidian

## 2. *Restrictions Under the 2007 CBRC Regulations*

If the Trust Law were the only framework governing trusts, Chinese trusts could take many forms, and family and public interest trusts could develop freely. However, the regulations issued under the law have imposed serious limitations. Rigid capital limitations and other requirements imposed by the 2007 regulations strictly limit who can act as settlor, trustee, and beneficiary.

The Rules on Trust Schemes of Collective Funds by Trust Companies, announced in 2007, impose burdensome restrictions on who can act as a settlor.<sup>87</sup> These regulations were meant to curb risky investment practices that had become endemic in the past decade, such as allowing innumerable beneficiaries to share in one pot of investment capital without any assessment of their financial situation.<sup>88</sup> To discourage such practices, the Rules on Trust Schemes dictate that no more than fifty individuals can participate in a single collective fund.<sup>89</sup> Each investor must also fall into one of the following categories:

- 1) Natural persons, legal entities or other organizations that invest no less than RMB 1 million in a single trust scheme;
- 2) Natural persons who can provide [a] relevant property certificate that his/her personal financial assets or family assets are more than RMB 1 million in total at the time of subscription;
- 3) Natural persons who can provide [an] income certificate that his/her annual personal income exceeds RMB 200 thousand or annual conjugal income is over RMB 300 thousand in the last three years.<sup>90</sup>

These requirements are not quite as onerous as they may initially seem. An annual income of RMB 200,000, for example, is only \$33,300 a year. However, this is still well above the average income for

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Canjiren Gongyi Xintuo (广东拟试点残疾人公益信托) [Guangdong Intends to Pilot a Charitable Trust for the Disabled], China News, Jan. 10, 2012, <http://www.chinanews.com/df/2012/01-10/3594372.shtml> (Guangdong).

<sup>87</sup> First off, it should be noted that nearly every settlor will have to conform with the Rules on Trust Schemes, which apply to any trust that has more than one settlor contributing money to it. In order to act as settlor and not be bound by these rules, a settlor would essentially have to provide all the capital for a trust fund (RMB 200 million under current regulations), which of course is impossible for all but the wealthiest individuals.

<sup>88</sup> See LI YONG, XINTUO YE JIANGUAN FALU WENTI YANJIU (信托业监管法律问题研究) 148–49 (2008) (arguing that China's efforts to curb risky investments in trust companies arose in part because of the lingering mentality that "in the end, the government will pick up the tab").

<sup>89</sup> Rules on Trust Schemes of Collective Funds by Trust Companies, *supra* note 50, art. 5. However, there is no limit on the number of institutional investors. *Id.*

<sup>90</sup> *Id.* art. 6.

China, where the per capita GDP is only \$9800.<sup>91</sup> This puts such trusts out of the reach of anyone except institutional investors and relatively wealthy individuals.<sup>92</sup>

The Rules on Trust Schemes also limit who can be designated as a beneficiary, stating that “[c]lients participating in the trust scheme [must be] the only beneficiaries.”<sup>93</sup> All collective trusts must therefore be self-settled, meaning they must be settled by the beneficiary. This requirement makes clear that, at least as envisioned by the CBRC, Chinese trusts are entirely different from the American concept of trusts. In the United States, the primary purpose of trusts is to allow a settlor to have his or her money used for the benefit of another.<sup>94</sup> By requiring the settlor to also be the beneficiary, however, the Rules on Trust Schemes have turned the trust form into essentially an ordinary investment vehicle. This also explains why the Trust Law gives settlors the seemingly odd right to have dispositions set aside.<sup>95</sup> That seems to be a right that would be more logically given to the beneficiary; but when the settlor and the beneficiary are always the same person, giving the right to the settlor accomplishes precisely the same thing.

The Rules Governing Trust Companies also restrict who can act as trustee. The Rules state that only trust companies that meet all statutory and regulatory requirements can act as trustees, and that “[n]o entities can engage in trust business without approval of the CBRC.”<sup>96</sup>

Together, the Rules Governing Trust Companies and the Rules on Trust Schemes place strict limitations on who can be a settlor, a trustee, or a beneficiary. These restrictions are such that if they apply to family and public interest trusts, those small-scale trust forms will

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<sup>91</sup> *CIA World Factbook: China*, CENTRAL INTELLIGENCE AGENCY (June 22, 2014), <https://cia.gov/library/publications/the-world-factbook/geos/ch.html>.

<sup>92</sup> Some trust companies and banks have conspired to avoid these strict limitations. In 2012, Guangda Bank announced a product that allowed trust investments of as little as RMB 10,000 (other companies have offered similar products with thresholds of RMB 50,000). The companies justify this structure on the grounds that this product is not a collective fund; the banks are doing the combining, after which they sell one large package to trust companies. See Bank Rate Forum Economic Report, “5 wan qibu: yinhang jiang menkan fangxing xintuo touzi” [Starting at RMB 50,000: Banks Lower Thresholds to Allow Trust Investment] (discussing a particular trust-combining strategy to avoid Trust Rules regulation while noting its high-risk, high-reward nature). However, this is widely recognized to be “playing at the very edge” of the law. *Id.*

<sup>93</sup> Rules on Trust Schemes of Collective Funds by Trust Companies, *supra* note 50, art. 5. The original Chinese is even more explicit: The word translated as “client” is in fact the word for “settlor.”

<sup>94</sup> See *supra* notes 15–16 and accompanying text.

<sup>95</sup> Rules Governing Trust Companies, *supra* note 40, art. 22.

<sup>96</sup> *Id.* art. 7. The rule goes on to state that in order to obtain CBRC approval, a trust company must apply and meet strict requirements, including having articles of association, a certain amount of registered capital, and other burdensome restrictions. *Id.*

be virtually impossible. If such a broad interpretation is correct, only the wealthiest settlors can create trusts, and even then they can specify only themselves as beneficiaries. Determining the scope of the 2007 regulations is therefore essential to determining whether small-scale trusts like the one that Mrs. Wang hoped to set up for her daughters are possible.

### *B. The Scope of the CBRC Regulations*

For trusts that fall within their ambit, the CBRC regulations impose extremely strict limitations on who can act as settlor, trustee, and beneficiary. As described above, these restrictions are such that if they apply to family and collective civil trusts, such noncommercial trust forms will be virtually impossible. Thus, in order to determine the practicability of forming such trusts to help people like Mrs. Wang and her daughters, it is critical to determine the scope of these regulations.

By their terms, the CBRC regulations apply to anyone engaged in “trust business” (信托业务), and as mentioned above, “[n]o entities or individuals can engage in trust business without the approval of the CBRC.”<sup>97</sup> The term “trust business” is defined as “the operation that a trust company accepts the entrustment and deals with the entrustment affairs as the trustee for the purpose of operation and remuneration.”<sup>98</sup> Strictly interpreted, this would make the earlier prohibition of trust business by non-trustees redundant: No act by a non-trust company could qualify as “trust business” to begin with. But this cannot be right. The most natural interpretation is that only a duly registered and approved trust company can accept an entrustment or fulfill the duties of a trustee, at least if it is paid for its services. In essence, this means that only trust companies can act as trustees.<sup>99</sup>

Those hoping to narrow the apparently broad scope of these rules may be tempted to rely on the distinction between “business” (商事) and “civil” (民事) trusts, arguing that the CBRC regulations govern only business trusts. Textually, distinguishing civil trusts could rescue smaller-scale trusts by limiting the definition of “trust business”

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<sup>97</sup> *Id.* art. 7.

<sup>98</sup> *Id.* art. 2. Here again, the official English translation is unclear, and in this instance even grammatically incorrect. A more accurate translation would be “the term ‘trust business’ in these rules refers to a trust company’s act of committing to an entrustment and to carrying out the duties of a trust in the role of a trustee, for the purpose of business operation and receiving remuneration.”

<sup>99</sup> See Wang & Zhou, *supra* note 76, at 163 (“Under PRC Trust Law, a trustee can be a natural or legal person with full legal capacity. However, only trust companies licensed by the CBRC can engage in trust business . . . . This, in essence, makes trust companies the main players as trustees.” (citations omitted)).

(信托业务)—which the CBRC regulations govern—to cover only what the Trust Law refers to as “business” (商事) trusts. This distinction is mentioned briefly in the Trust Law itself: Article Three states that “[t]his Law shall be applicable to the settlers [sic], trustees, and beneficiaries . . . that engage in civil, business or public-welfare trust activities . . . .”<sup>100</sup> A business trust is probably the kind formed by trust companies. A public welfare trust is one that conforms to the detailed guidelines in the Trust Law.<sup>101</sup> A civil trust, however, is more difficult to define. Civil laws include many diverse areas, including family law, inheritance law, labor law, and others, making even this commonsense definition unhelpfully vague.

If the term “business” (业务) had the same meaning in the regulations as the word “business” (商事) in the Trust Law, where it is contrasted with “civil,” this justifying distinction would be possible. But there is no reason to think the two are at all related. The surface identity of the word “business” between the trust law and the regulations is deceptive; in the original Chinese, the words are entirely different. The word “business” (商事) (as opposed to “civil”) in the Trust Law refers to business as a moneymaking enterprise, and could be considered a synonym of “commercial.” The word “business” (业务) as used in the Rules Governing Trust Companies has a less commercial connotation, and refers to one’s vocation or profession.<sup>102</sup>

Probably the only clear and textually justified distinction between civil and business trusts is that offered by Professor Lingyun Gao: “The difference between civil and business trusts primarily lies in whether the trustee, at the time that the settlor transferred the trust property, receives consideration from the settlor.”<sup>103</sup> If this is the correct definition, then the CBRC regulations do indeed cover only commercial trusts. The Rules Governing Trust Companies, after all, only apply to trusts performed “for the purpose of . . . remuneration.”<sup>104</sup> But excluding civil trusts from the ambit of the CBRC regulations by defining civil trusts so narrowly would be a Pyrrhic victory. In the United States, it is generally expected that even family members who act as trustees for private family trusts will receive some remunera-

<sup>100</sup> Trust Law, *supra* note 34, art. 3.

<sup>101</sup> See *supra* notes 84–86 and accompanying text.

<sup>102</sup> This difference is not surprising; even in English, the two are different parts of speech. In the phrase “trust business,” the word “business” is a noun, but in the phrase “business trust,” it is an adjective.

<sup>103</sup> Gao Lingyun (高凌云), *Bei Wudu de Xintuo (被误读的信托)* 205 (2010). This “consideration” presumably includes promises of future remuneration. There is no reason to think that the distinction turns on whether the trustee is given the money at the time the property is transferred or at some later date.

<sup>104</sup> Rules Governing Trust Companies, *supra* note 40, art. 2.

tion.<sup>105</sup> Acting as a fiduciary can be difficult, and therefore all but the most basic trusts will involve some sort of remuneration. If CBRC regulations cover all trust arrangements in which the trustee is paid, essentially all useful trusts will be subject to those rules.<sup>106</sup>

The existence of public-welfare trusts does lend support to the idea that CBRC regulations do not occupy the field, which could be helpful in arguing that they do not govern civil trusts. After all, the Trust Law mentions “civil, business [and] public welfare trusts” together.<sup>107</sup> Because public welfare trusts exist on a fairly large scale and have been legitimated by (and indeed formed by) the government, at least the distinction between the latter two—business and public welfare trusts—must be real. In other words, the phrase “trust business” (信托业务) as it occurs in the CBRC regulations cannot be interpreted to cover public welfare trust activities. If the regulations were interpreted to completely occupy the field and preclude even public welfare trusts, then the Beijing and Guangdong governments would be in violation of the law. The regulations are not likely to be interpreted in a way that invalidates such established institutions.

Nevertheless, there are two reasons that the existence of public welfare trusts is unlikely to be much help in the effort to give legal effect to the civil/commercial distinction. First, unlike civil trusts, public welfare trusts are explicitly defined (rather than merely mentioned) in the law, which makes the distinction easier to maintain.<sup>108</sup> The civil/commercial distinction, however, is not defined in the Trust Law or anywhere else, and may therefore be more difficult to maintain as a way to avoid the CBRC requirements. Second, “trust business,” which defines the scope of the CBRC regulations, is defined as operation of a trust for remuneration.<sup>109</sup> While trustees will be remunerated in most civil trusts, the government departments that run the already established public welfare trust funds do so as a government

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<sup>105</sup> See ABA, *Guidelines for Individual Executors & Trustees*, AMERICAN BAR ASSOCIATION, [www.americanbar.org/groups/real\\_property\\_trust\\_estate/resources/estate\\_planning/guidelines\\_for\\_individual\\_executors\\_trustees.html](http://www.americanbar.org/groups/real_property_trust_estate/resources/estate_planning/guidelines_for_individual_executors_trustees.html) (last visited Jan. 28, 2015) (stating that “[b]ecause being fiduciary is time-consuming and is often difficult, it is appropriate to be paid for your services,” but that “[m]any fiduciaries in the same family as the decedent are quick to waive fees”).

<sup>106</sup> For instance, if anyone else—including an individual—tried to form a trust, it would simply be a loan with contractual agreements attached, and therefore would be vulnerable to claims of creditors, disposition in divorce, and other liabilities.

<sup>107</sup> Trust Law, *supra* note 34, art. 3.

<sup>108</sup> Trust Law, *supra* note 34, art. 60 (defining charitable or public welfare trusts).

<sup>109</sup> Rules Governing Trust Companies, *supra* note 40, art. 2.

duty and not because they are paid to do so.<sup>110</sup> It would be interesting to see what courts do if privately run public welfare trusts are formed in which the trustee receives some remuneration. If this occurs, courts will have to face squarely the issue of the scope of the CBRC's regulations.

In short, the argument that civil trusts are not subject to the CBRC regulations is colorable. However, because the distinction is not explained anywhere and, most importantly, because the CBRC regulations do not restrict their coverage by reference to this distinction, it is unlikely that such an argument would succeed. The most plausible distinction between civil and commercial trusts—and the standard which the CBRC regulations seem to use—is that all trusts in which the trustee is remunerated are commercial trusts. Courts may therefore be willing to uphold and enforce small civil trusts in which the trustee is not paid. But it is unlikely that paid trustees would be exempted from the regulation even if they manage private family trusts. And a large-scale, institutionalized system of civil trusts certainly could not be supported on so thin a legal reed.

This analysis shows that although the possibilities of the trust form are quite broad under the Trust Law alone, the CBRC regulations impose strict limits on the types of trusts that can be created and enforced. There is probably an exception for public welfare trusts and likely another exception for private civil trusts without trustee remuneration, but the vast majority of useful trust forms fall under the regulations and thus are beyond the reach of all but the extremely wealthy.

### *C. Are Noncommercial Trusts Feasible Under the Current Framework?*

#### *1. The Feasibility of Private Family Trusts*

The original—and still an extremely important—function of trusts in the common law world is management of family wealth.<sup>111</sup> With growing inequality in China and the appearance of super-rich High Net Worth Individuals, some families have shown interest in using the trust form as a wealth management tool rather than simply as an investment device.<sup>112</sup> In doing so, these families have looked to American models: The United States has trust forms that allow fami-

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<sup>110</sup> See, e.g., Hong, *supra* note 86 (detailing Beijing's planned effort to provide affordable housing through a trust program); Wu, *supra* note 86 (describing these public welfare trusts).

<sup>111</sup> *Supra* Part I.

<sup>112</sup> See *infra* note 116 and accompanying text.

lies to transfer wealth and protect it from creditors.<sup>113</sup> Most commonly, a family will create a trust that will periodically pay money to their children.<sup>114</sup> Often, when the children reach a certain age, the trust form is dissolved and the children receive the balance.<sup>115</sup> This section investigates to what extent such forms are possible in China under current law.

Although these private trusts are almost unheard of in China, a few have been reported to exist. In July 2013, for example, the Beijing Youth Daily reported on the first ever “trust baby” in China.<sup>116</sup> The child, the daughter of a certain Mr. Yang, had a “Paris Hilton-style” trust set up in her name at the age of eight.<sup>117</sup> The trust was set up through a private bank which had a professional trust company act as trustee.<sup>118</sup> The product offered by the two companies was billed as a family trust, but its minimum investment was RMB 5,000,000, which is obviously well beyond the means of most families.<sup>119</sup> This form of trust mostly conforms to the structure established by the CBRC regulations, but there is one unique aspect that could end up being fatal. As mentioned above, the Rules on Trust Schemes of Collective Funds specify that the settlor of a trust must also be its sole beneficiary.<sup>120</sup> Although the reports do not specify precisely how this “Paris Hilton trust” was structured, there are two forms that Guangda Bank might have used. First, it may simply have set up an ordinary commercial trust at a trust company with Mr. Yang’s money and specified his daughter as the beneficiary. Such a trust would presumably be void because it is subject to and blatantly violates CBRC rules, which require the settlor to be the sole beneficiary. Alternatively, the bank may also have set up an account with the trust company of which the bank itself is both settlor and beneficiary. After receiving the income from the trust, it then may act as trustee for a second “civil” trust with Mr. Yang’s daughter as beneficiary. However, even this second trust would likely be void, because although the trustee is not a trust company, the bank certainly is remunerated, and this likely brings it under

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<sup>113</sup> See AUSTIN W. SCOTT & WILLIAM F. FRATCHER, *THE LAW OF TRUSTS* § 151 (4th ed. 1987) (describing spendthrift trusts).

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> Cheng Jie, *8 Sui Nuhai Cheng Guonei Shoudan Xintuo Baobei* [8 year old girl becomes China’s first trust baby], *BEIJING QINGNIAN BAO*, Jul. 22, 2013, available at <http://bjyouth.yinet.com/3.1/1307/18/8145979.html>.

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

<sup>119</sup> *Id.*

<sup>120</sup> Rules on Trust Schemes of Collective Funds by Trust Companies, *supra* note 50, art. 5.

the scope of the regulations as well. And if it is subject to the regulations, it could not specify someone other than the settlor as beneficiary.<sup>121</sup>

Another innovative use of trusts can be seen in one lawyer's attempt to use a civil trust to resolve a family drama.<sup>122</sup> Gao Fengyang of Jiangsu province had a wife and two daughters. However, in 2007 he met a younger woman, Hao Lili, through his business activities, and had an affair with her.<sup>123</sup> The two had a son, and Mr. Gao ended up buying her an RMB 8,000,000 apartment and giving her RMB 7,000,000 in cash, most of which Ms. Hao invested.<sup>124</sup> In doing so, he used his and his wife's property indiscriminately.<sup>125</sup> His wife eventually found out, and although she initially wanted to divorce him and sue to have her property returned, the two eventually reconciled.<sup>126</sup> However, this still left the matter of the property. Ms. Hao wanted to raise the child on her own, and Mr. Gao wanted to continue to provide for the child in some way.<sup>127</sup> However, Mr. Gao's wife understandably did not want Mr. Gao and Ms. Hao to have any ongoing relationship, even if it was purely to discuss the money.<sup>128</sup>

This presented a difficult problem, and a lawyer proposed a trust as an innovative solution. Essentially, he proposed that Ms. Hao return all money that was jointly owned by Mr. and Mrs. Gao, and then Mr. Gao would form a trust with his own money.<sup>129</sup> This trust would name Ms. Hao as the trustee and their son as beneficiary, which would limit Ms. Hao to using the money only for the benefit and support of her son.<sup>130</sup> The lawyer also believed that by doing so, he could prevent Ms. Hao from actually gaining ownership over the money and give Mr. Gao some authority to step in and prevent abuses.<sup>131</sup> The trust was eventually formed with RMB 5,000,000.<sup>132</sup> This trust is perhaps even more innovative than the basic family trust considered earlier. In this case, the trust did not involve a trust company at all.

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<sup>121</sup> Unfortunately, the limited news reports about this trust do not indicate which of these forms was used or whether it has been challenged in court.

<sup>122</sup> Wang Xiaocheng, *Minshi Xintuo zai Jiashi Falu Shiwu zhong de Yingyong yu Shixian Chutan* (民事信托在家事法律事务中的应用与实践初探), SHANGHAI LUJIA LAW FIRM, (June 26, 2013, 12:23 PM), [http://blog.sina.com.cn/s/blog\\_60d317b40101apva.html](http://blog.sina.com.cn/s/blog_60d317b40101apva.html).

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

<sup>125</sup> *Id.*

<sup>126</sup> *Id.*

<sup>127</sup> *Id.*

<sup>128</sup> *Id.* After all, it was through business that the two met in the first place. *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

Indeed, an individual was appointed as trustee. Ms. Hao presumably acted without remuneration, and this fact may mean that the trust does not fall under the CBRC regulations and is therefore perfectly legal.

Finally, the Shanghai Oriental Notary Public Office has recently notarized a number of wills containing testamentary trusts.<sup>133</sup> In one case, an elderly woman wrote a will providing that after her death, her home should be given to a non-profit organization for use by high-need students.<sup>134</sup> In another, a will provided that shares in a residence would be given to a family member to be managed for the benefit of the testator's daughter.<sup>135</sup> Both of these trusts, if actually formed, would be groundbreaking. The notarization is only the first step, however. Because they are contained in wills, the trust will be created only upon the death of the testators.<sup>136</sup> Whether the trust form is retained and how it is enforced in these cases remains to be seen. Practically speaking, until the regulations are changed, those arranging such trusts can never be confident that they will be enforceable.

All of these trusts were formed very recently, and no court has weighed in on their legitimacy. Such novelties as having someone other than the settlor as beneficiary, having an individual act as trustee, and allowing testamentary trusts are certainly consistent with the language and spirit of the Trust Law, but they may have been made impossible by the CBRC regulations.<sup>137</sup> If such small-scale trusts are ever challenged, it is possible that some practically-minded courts may be willing to uphold and even enforce them. However, a stable, developed system of civil trusts is very unlikely under this system: The ambiguities and unresolved issues within the Trust Law and the regulations will likely continue to hamper the growth of civil trusts.<sup>138</sup>

## 2. *The Feasibility of Pooled Self-Settled Trusts in China*

The above analysis shows that among noncommercial trusts, public welfare trusts are the easiest to justify. Individual family trusts are more difficult but may be possible if the trustee is not remunerated. As this section shows, a collective trust in which a nonprofit

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<sup>133</sup> See Gao, *supra* note 66, at 358 (detailing wills containing complicated trust provisions).

<sup>134</sup> *Id.*

<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

<sup>137</sup> See *supra* Part II.B (analyzing CBRC regulations and their challenges to Chinese trust law).

<sup>138</sup> See *supra* notes 66 and accompanying text (discussing the CBRC regulations and the motivation behind them).

group acts as trustee would be even more difficult to set up under the current legal framework. In the United States, such trusts are referred to as pooled self-settled trusts.<sup>139</sup> In these trusts, each beneficiary has his or her own account, but for investment and management purposes, the assets are pooled.<sup>140</sup> The nonprofit group acting as trustee uses the funds to pay for the needs of beneficiaries that are not covered by government benefits.<sup>141</sup> These trusts are a form of supplemental needs trust, meaning that they supplement government benefits and are not considered income when calculating such benefits.<sup>142</sup> Such trusts are very helpful for disabled and elderly beneficiaries because they provide an additional source of income without reducing the beneficiaries' benefits under Medicaid or any other government program.<sup>143</sup> Normally, to the extent possible, supplemental needs trusts are required to repay the government for all previous benefits following the beneficiary's death.<sup>144</sup> However, pooled self-settled trusts have the additional benefit that, following the beneficiary's death, the assets of the trusts go to the nonprofit group that acted as trustee.<sup>145</sup> These

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<sup>139</sup> See Abraham J. Perlstein, *Comprehensive Future Care Planning for Disabled Beneficiaries*, ESTATE PLANNING 360, 365–66 (Oct. 2000) (providing an overview of pooled, self-settled trusts). It is important to note that the phrase “self-settled” does not mean that the money must come from the beneficiary. A parent, relative, or anyone concerned can contribute money to such a fund. “Self-settled” simply makes clear that the assets of such trusts do not come from the organizations acting as trustee.

<sup>140</sup> *Id.* at 365.

<sup>141</sup> *Id.* at 365–67.

<sup>142</sup> *Id.* at 365.

<sup>143</sup> Such trusts were originally developed as a hybrid of “support trusts” and “discretionary trusts.” See Joseph A. Rosenberg, *Supplemental Needs Trust for People with Disabilities: The Development of a Private Trust in the Public Interest*, 10 B.U. PUB. INT. L.J. 91, 108 (2000) (examining the development of supplemental needs trusts and their underlying rationale). The supplemental needs trust is also a type of spendthrift trust, so it is unreachable by the beneficiary's creditors. *Id.*

<sup>144</sup> Perlstein, *supra* note 139, at 365. This “payback” provision takes the form of a lien that the government has over the trust. See 42 U.S.C. § 1396p(d)(4)(a) (2012) (“[T]he State will receive all amounts remaining in the trust upon the death of such individual up to an amount equal to the total medical assistance paid on behalf of an individual under a State plan . . .”). In addition to the payback requirement, there are several other substantial limitations on supplemental needs trusts. Most importantly, in order not to qualify as accessible income, the trust itself must pay for services. The trustee cannot give money directly to the beneficiary, even if the beneficiary has the mental capacity to spend it prudently. Even if the expense is as paltry as a movie ticket, the trust has to pay for it directly. This means that the trust is useful primarily as a way of paying for large or regularly scheduled expenses.

<sup>145</sup> However, Medicaid still takes precedence over all other claimants, including family members. A pooled trust is therefore not a way to retain money that would otherwise escheat to the government.

trusts were first authorized in 1993 as part of an amendment to the Medicaid Act.<sup>146</sup>

The CBRC regulations, however, make it very unlikely that such a trust would be possible in China. At the outset, it is important to distinguish between a collective trust of this type and a public welfare trust. A public welfare trust takes money from somewhere else and gives it to anyone who fits the established criteria.<sup>147</sup> A collective trust, on the other hand, is essentially an amalgamation of individual trusts. Each account in the trust is established by a different settlor and devoted to a different beneficiary. Such a trust is basically an individual trust on a public welfare scale. It therefore encounters the problems of both.

Such a trust has never been attempted in China,<sup>148</sup> although the possibility has been investigated. One group analyzed the possibility of having a disabled persons' federation act as trustee.<sup>149</sup> Disabled persons' federations exist in many Chinese cities and were officially legitimized in the "Law on the Protection of People with Disabilities," which authorized the national China Disabled Persons' Federation to "represent the common interests of persons with disabilities . . . and provide service for [them]."<sup>150</sup> It also authorized the creation of local and regional branches of the national organization, all of which were directed to "mobilize social forces" on behalf of people with disabilities.<sup>151</sup> Establishing a pooled trust would certainly be an important

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<sup>146</sup> 42 U.S.C. § 1396p(d)(4)(C) (2012). The idea of the supplemental needs trust predated this statute in many states, which allowed for trusts that had similar effects vis-à-vis their own state welfare programs. The idea extends as far back as the case of *In re Escher*, 407 N.Y.S.2d 106, 111 (Sur. Ct. Bronx Co. 1978), *aff'd*, 426 N.Y.S.2d 1008 (N.Y. App. Div. 1980), *aff'd*, 420 N.E.2d 91 (1981), which ruled that New York State did not have a right to be reimbursed by a trust established by Martin Escher for his daughter Marie, who was cared for by the state.

<sup>147</sup> See Gao, *supra* note 103, at 196 (defining a public welfare trust as "a trust established for the benefit of the indefinite public").

<sup>148</sup> One possible exception is the will notarized in Shanghai that would devote an elderly woman's home to charitable purposes. See *supra* note 134 and accompanying text. However, strictly speaking, this trust will not be created until the testator's death.

<sup>149</sup> Canjiren Lianhehui Zuowei Shoutuoren Guanli Canjiren Caichan Kexingxing Fenxi [Analysis of the Feasibility of a Disabled Persons' Federation Acting as Trustee and Managing Disabled People's Property], FALU KUAICHE [LAW EXPRESS], July 7, 2010 [hereinafter Analysis of the Feasibility of a Disabled Persons' Federation], available at <http://xintuo.lawtime.cn/xtcc/2011071026277.html>.

<sup>150</sup> Zhonghua Renmin Gongheguo Canjiren Baozhangfa art. 8 (中华人民共和国残疾人保障法) [Law on the Protection of People with Disabilities of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 28, 1990, effective May 15, 1991) [hereinafter Law on the Protection of People with Disabilities], 1990 STANDING COMM. NAT'L PEOPLE'S CONG. GAZ., available at [http://www.gov.cn/ztl/gacjr/content\\_459363.htm](http://www.gov.cn/ztl/gacjr/content_459363.htm).

<sup>151</sup> *Id.*

step forward in the group's mission. However, the group determined that such a structure would currently be impossible because of the inherent limitations of the Trust Law.<sup>152</sup>

Perhaps the largest obstacle is the qualifications for acting as trustee under the Trust Law. As noted above, only entities with legal personhood can act as trustees. The China Disabled Persons' Federation is a "semi-official"<sup>153</sup> organization with governmental authorization that serves and represents people with disabilities.<sup>154</sup> It therefore does not seem to have legal personhood. The best argument to the contrary—i.e., that it does have legal personhood—is that it could be seen as an "enterprise unit," which, according to China's civil procedure regulations, can be sued in a civil suit. But even if the federation qualifies as an "enterprise unit," it is not settled that being subject to suit implies legal personhood in all cases. Although this requirement may make such pooled self-settled trusts impossible, the problem seems to lie with Chinese associational and entity law, rather than with trust law specifically. Although the rights and obligations that go along with legal personhood may not be entirely clear under Chinese law, it certainly is not unreasonable to require a trustee to have the capacity to sue and be sued. The solution should be to grant such semi-official organizations legal personhood explicitly, rather than to loosen the legal requirements for who can act as trustee.

However, even if such an association had legal personhood, there are several obstacles that would make any such trust extremely difficult to establish. One major obstacle comes from the Rules on Trust Schemes. These apply to "collective funds trust schemes," which are defined as "entrusted funds management activities where a trust company acts as a trustee, in line with the clients' will, to manage, use or dispose of the funds entrusted by two or more clients in a collective manner with a view to benefiting the beneficiaries."<sup>155</sup> At first glance, it seems that this rule might be avoided simply by appointing some entity other than a trust company as trustee. But clearly it cannot be that simple: A trust company could not simply start calling itself an "investment entity" and thereby avoid the requirements.

Indeed, "trust company" is a defined term in the regulations: "The term 'trust company' in these Rules refers to the financial institutions which are mainly engaged in trust business and established in

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<sup>152</sup> See Analysis of the Feasibility of a Disabled Persons' Federation, *supra* note 149 (arguing that because of the Trust Law's requirement of registration and other issues, such a trust would be impossible).

<sup>153</sup> Literally translated, "half official, half popular."

<sup>154</sup> Analysis of the Feasibility of a Disabled Persons' Federation, *supra* note 149.

<sup>155</sup> Rules on Trust Schemes of Collective Funds, *supra* note 50, art. 1–2.

accordance with the Company Law of the People's Republic of China and these Rules."<sup>156</sup> An entity seeking to manage a noncommercial collective trust would likely fall under this definition. Of course, one could argue that if the entity does not "mainly" engage in trust business, it is not subject to the regulation. But it is unlikely that a court would interpret the regulations to allow companies to evade the rules as long as they only rarely manage trusts. Indeed, it would be very odd to say that those companies with less expertise are exempt from regulation. Therefore, probably the only way that noncommercial collective trusts can avoid the regulations is if the regulations do not govern noncommercial trusts. This means that once again, the issue hinges on the question of what counts as "trust business." If "trust business" contemplates a distinction between civil and commercial trusts,<sup>157</sup> and if the fact that the trustee is remunerated does not automatically put such trusts on the commercial side of the line, these pooled trusts may not be subject to CBRC regulations.

However, even if the civil/commercial distinction does make such trust funds theoretically possible, it is very unlikely that a court would interpret the Trust Law or the CBRC regulations to exclude a non-profit organization running a collective trust fund. For one thing, what a noncommercial collective trust does is very similar to what a trust company does. Both provide a low risk investment vehicle and "manage, use, or dispose of funds entrusted by two or more clients."<sup>158</sup> Their primary difference lies in the fact that noncommercial trustees, like those for pooled self-settled trusts, have a more active role in determining how the funds are used. But it would be difficult to convince a court that because the trustee is more involved in the beneficiary's rights, it should be subject to less regulation. And risk of loss is still present even in a collective civil trust. Essentially, by promulgating the 2007 regulations, the Chinese government made a decision that the risks associated with trust companies were best mitigated by allowing only sophisticated, wealthy investors to use them. If all the rules could be avoided simply by calling a trust a "civil" trust, this regulatory regime would be thwarted.

Perhaps most importantly, however, such a trust would be practically difficult because there is no governmental entity to register or oversee it. As noted earlier, the Trust Law itself does not actually impose any such registration requirement, but other laws or regulations could do so. For pooled funds, including trusts, such a require-

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<sup>156</sup> Rules Governing Trust Companies, *supra* note 40, art. 2.

<sup>157</sup> See *supra* note 98 and accompanying text (evaluating whether the phrase "trust business" does in fact incorporate such a distinction).

<sup>158</sup> Rules on Trust Schemes of Collective Funds, *supra* note 50, art. 1.

ment is imposed by a criminal law forbidding illegal fundraising.<sup>159</sup> The illegal fundraising law as initially passed was somewhat unclear, but a recent official interpretation by the Supreme People's Court has clarified that fundraising is illegal if it satisfies four elements: First, it is done without registering the fund with the relevant governmental department; second, the fund advertises itself to the public; third, the fund promises to repay money within a specified period of time; and fourth, the targeted people are indefinite members of the public.<sup>160</sup> This law seems to imply, although it does not directly state, that all legitimate fundraising activities have to be registered with some department. Even though someone raising funds without registration could claim that he or she did not fulfill the other elements of the crime, it would seldom be worth it to run the risk, especially considering that the other elements are vague and could be met accidentally.

The stakes here are even higher than they may initially seem. Such an illegal trust would not only be void and unenforceable, it could also subject a person to civil and criminal penalties. Since 2011, China has brought over 4000 indictments for illegal fundraising, and penalties were assessed in nearly all of these cases, with almost 35% of those convicted facing five or more years in jail.<sup>161</sup> In some cases, violators have even faced the death penalty.<sup>162</sup> In the midst of a widespread crackdown on unregistered fundraising, it is extremely unlikely that Chinese courts would allow any pooled trust fund that was not supervised by some government agency. Collective trusts are therefore very unlikely to arise in China's current legal climate.

In short, Chinese trust law is plagued by ambiguity, vagueness, and even inconsistency. The Trust Law itself is still unclear in some areas and especially hinders the growth of trusts by failing to explicitly distinguish civil from commercial trusts. The CBRC regulations are

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<sup>159</sup> Steven Wei Su, Criminal Liabilities for Illegal Fundraising in China (Guo Lian Law Firm), available at <http://www.hg.org/article.asp?id=20800> (reporting on 2010 clarifications to laws on illegal fundraising). The English word "fundraising" is more general than the Chinese word used, "jizi," which means specifically accumulating or pooling capital.

<sup>160</sup> Zuigao Renmin Fayuan Guanyu Shenli Feifa Jizi Xingshi Anjian Juti Yingyong Falu Ruogan Wenti de Jieshi (最高人民法院关于审理非法集资刑事案件具体应用法律若干问题的解释) [Supreme People's Court Explanation of Several Questions About Concrete Application of Hearings for Cases of Criminal Unlawful Fundraising] (Sup. People's Ct. 2010) (China), available at <http://www.mps.gov.cn/n16/n1282/n3493/n3838/2921956.html>.

<sup>161</sup> *China to Tighten Crackdown on Illegal Fundraising*, Apr. 27, 2013, XINHUANET, [http://news.xinhuanet.com/english/china/2013-04/27/c\\_124637967.htm](http://news.xinhuanet.com/english/china/2013-04/27/c_124637967.htm) (Mu Xuequan, ed.). Out of 4293 cases prosecuted, penalties were assessed in 4170. *Id.*

<sup>162</sup> Dinny McMahon, *Investor Scheme Leads to Death Sentence*, WALL ST. J., May 17, 2013, <http://online.wsj.com/news/articles/SB10001424127887323398204578488831032664720> (reporting that among others, Lin Haiyan, a businesswoman from Wenzhou, was sentenced to death in May 2013 for running a multimillion dollar Ponzi scheme).

extremely restrictive, limiting trusts to only the wealthiest individuals where the regulations apply. Because the scope of the regulations is still unclear, and may extend to all trusts in which the trustee is paid, these rules inhibit the growth of private and collective civil trusts. Finally, because illegal fundraising is a crime and because the standards for “illegality” are so uncertain, establishing a collective trust will almost never be worth the risk of criminal liability.

### III POSSIBLE REFORMS

Conceptually, Chinese trust law is a bit of a mess. Luckily, the confusion is mostly superficial. Most kinds of trusts have already made some inroads into China. It is the law and governmental regulation that need to catch up with civil society and find ways to accommodate all or most useful trust forms. There are two ways to accomplish this: the easy way and the thorough way. The easy way has two steps: First, the CBRC can issue new regulations making clear that their rules apply only to commercial trusts, as well as give a workable definition of commercial as opposed to civil trusts; and second, some other government organ (or perhaps the CBRC itself) can promulgate its own rules regulating civil trusts. The thorough way, on the other hand, follows the path of other Asian countries, most notably Taiwan.<sup>163</sup> This would require revising the Trust Law and promulgating a new law, the Trust Enterprise Law, to more clearly distinguish civil and commercial trusts. It could also include giving courts the power to develop doctrine in the area of trusts as well.

Thankfully, these routes are not mutually exclusive. A CBRC regulation clarifying its authority could be an effective stopgap while laws are developed that define and authorize regulation for civil trusts. A full discussion of possible reforms is beyond the scope of this Note. However, the possibilities discussed in this section provide a firm groundwork for later development of creative and effective solutions.

#### A. *The Easy Way*

The CBRC could resolve much of the confusion simply by revising its regulations to clarify what type of trusts they apply to. For example, the regulations currently define the term “trust business” as “the operation that a trust company accepts the entrustment and deals with the entrustment affairs as the trustee for the purpose of opera-

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<sup>163</sup> See *infra* note 173 and accompanying text.

tion and remuneration.”<sup>164</sup> A better definition may be: “The act of accepting a trusteeship with the expectation of remuneration for the purpose of investment (what is referred to in the Trust Law as a ‘commercial trust’), as opposed to active management for the primary purpose of controlling the disbursement and use of funds (what is referred to in the Trust Law as a ‘civil trust’).” Sharply distinguishing civil from commercial trusts in this way could have an effect on Chinese trusts similar to the effect that the Statute of Uses, which distinguished between active and passive uses, had on English trusts.<sup>165</sup> Such a distinction would help curb excessive risk-taking, facilitate taxation, and generally treat these “trusts” as what they are—investment vehicles. At the same time, it can allow many uses of the trust form to grow without being subject to regulations that properly apply only to commercial trusts.

Such a change would immediately place individual civil trusts, such as family trusts,<sup>166</sup> on a much firmer footing. It would also pave the way for regulation of civil trusts, which could make collective civil trusts possible by putting some governmental department in charge of receiving and processing registrations of non-governmental trustees. As discussed further below, such regulations could also impose modest capital requirements, set up more operationalized standards for distinguishing between noncommercial collective trustees and for-profit trust companies, and impose other requirements to make sure that funds are not mismanaged.

### B. *The Thorough Way*

The more difficult, but ultimately more fruitful, path would be to amend the laws. Although this process would certainly be difficult, the time may be right for the change. The National People’s Congress has recently expressed interest in amending the Trust Law.<sup>167</sup> In amending the law, the legislature should keep in mind that trusts serve a wide range of functions and are not just straightforward investment tools. Most importantly, the new Trust Law should explicitly distinguish civil, commercial, and public welfare trusts. A definition mirroring that suggested above for the CBRC regulations would be appropriate. Just as the Trust Law now has a discrete section about public welfare trusts, it would be helpful to have distinct sections outlining the general rules for commercial and civil trusts.<sup>168</sup> Finally, the legislature

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<sup>164</sup> Rules Governing Trust Companies, *supra* note 40, art. 2.

<sup>165</sup> *See supra* note 12 and accompanying text.

<sup>166</sup> *See supra* Part II.C.1.

<sup>167</sup> Gao, *supra* note 66, at 361.

<sup>168</sup> *See supra* note 108 and accompanying text.

could ensure continuing development by granting courts the power to develop the doctrine on their own.

In some ways, China changed its trust law at an unfortunate time. Other Asian countries had trust laws on the books for decades by the time that China passed its first law in 2001.<sup>169</sup> Japan passed its first trust law in 1922,<sup>170</sup> and South Korea followed in 1961.<sup>171</sup> By the early twenty-first century, however, these countries had realized that their trust laws were antiquated and limited. Japan again took the lead, amending its trust law in 2006.<sup>172</sup> Thus, the models China looked to in devising its Trust Law were already becoming out of date when the law was adopted in 2001. Although the recent wave of reform means China is already somewhat behind the curve in amending its Trust Law, it also gives the Chinese government many models on which to draw.

True reform cannot come from revising the Trust Law alone. Perhaps the most effective way to set civil trusts on a firm footing is to supplement the trust law with a Trust Enterprise Act to govern investment trusts, as has occurred in Taiwan.<sup>173</sup> A Trust Enterprise Act could have many benefits that are not seen in a system that has only one trust law supplemented with regulations. First, it would make the law more coherent by creating a different legal regime for each type of trust. Second, it would resolve preemption problems. Because it is also a statute, the Trust Enterprise Act can preempt the Trust Law in imposing requirements on commercial trusts, forestalling the con-

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<sup>169</sup> Ho, *supra* note 23 at 80.

<sup>170</sup> Wu Ying-Chieh, *Trust Law in South Korea: Developments and Challenges*, in TRUST LAW IN ASIAN CIVIL LAW JURISDICTIONS: A COMPARATIVE ANALYSIS 46, 46 (Lusina Ho & Rebecca Lee eds., 2013).

<sup>171</sup> Makoto Arai, *Trust Law in Japan: Inspiring Changes in Asia, 1922 and 2006*, in TRUST LAW IN ASIAN CIVIL LAW JURISDICTIONS: A COMPARATIVE ANALYSIS 27, 27 (Lusina Ho & Rebecca Lee eds., 2013).

<sup>172</sup> *Id.* at 28. The new statute clarified many points, including what constitutes “segregation” of the trustee’s personal assets from the trust property. *Id.* at 30. Perhaps more importantly, however, it allowed a type of trust that could be very useful outside the commercial context. The 2006 act allows a settlor to appoint herself as trustee; in other words, a settlor can simply turn any property into trust property by saying so. *Id.* at 29. This feature was unique in the world when it first appeared, *id.*, and certainly increases the risk of fraud. It was adopted primarily because it was considered ideal for securitizing assets; rather than appointing another entity, the seller of the assets can simply appoint himself trustee, and thus the buyer can be sure that the assets are indeed separate from the seller’s personal property before she decides to buy. *Id.*

<sup>173</sup> Wang Wen-Yeu, Wang Chih-Cheng, & Shieh Jer-Shenq, *Trust Law in Taiwan: History, Current Features and Future Prospects*, in TRUST LAW IN ASIAN CIVIL LAW JURISDICTIONS: A COMPARATIVE ANALYSIS 63, 65–66 (Lusina Ho & Rebecca Lee eds., 2013).

fusing effort of trying to interpret the regulations to conform with the law.

Taiwan's Trust Enterprise Act was passed in 2000, with a substantial amendment following in 2008.<sup>174</sup> The law and its amendments are meant to clarify the trustees' duty of loyalty in a business context, make clear which aspects of the trust law apply to commercial trusts, provide a structure for collective trust funds, and generally refine the government's role in supervising trusts.<sup>175</sup> By adding a Trust Enterprise Act, the Chinese government would be able to give a stronger basis for the rules applying to commercial trusts, while at the same time making clear where those rules are inappropriate. Even if the CBRC regulations could be interpreted to extend only to commercial trusts, it would certainly be better to have the distinction between commercial and civil trusts clearly stated rather than remain an ambiguity that unscrupulous investment advisers could use to their advantage.

These reforms would help China catch up to other Asian jurisdictions. But this may not go far enough. Indeed, even the most developed legal regimes in Asia have failed to adequately promote civil trusts. For example, Japan has failed to give any detailed guidance on how trusts can be created and administered in noncommercial contexts.<sup>176</sup> Thus, even in Japan, trusts are still primarily financial investment products.<sup>177</sup> No Asian jurisdiction has yet created a trust regime that is fully able to exploit the power of its civil society. China could fill this gap by adopting a regulatory or statutory regime that fosters such innovative trust forms. For example, China could adopt a regulation similar to the Rules on Trust Schemes that regulates pooled civil trusts. Such a regulation could designate a government entity to oversee trusts, receive registrations for trusts, impose specialized fiduciary requirements on the trustees, mandate some advertising and operating restrictions, and determine who can qualify as either settlor or beneficiary. Such a regulation or statute could be modeled after those creating American pooled self-settled trusts and similar state laws.<sup>178</sup>

China could encourage the use of civil trusts by using adapted versions of the methods of other Asian jurisdictions. For example,

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<sup>174</sup> *Id.*

<sup>175</sup> *Id.*

<sup>176</sup> Arai, *supra* note 171, at 45 (“[T]he new (2006) Act fails to spell out specific rules on the use of the trust in the family or other noncommercial contexts.”).

<sup>177</sup> *Id.* at 44 (“Currently in Japan, the trust is applied mainly in the commercial sphere . . .”).

<sup>178</sup> See *supra* note 146 and accompanying text.

Taiwan has recognized the need to amend other laws in order to change the legal regime surrounding trusts. Since the trust law was first enacted in 1996, Taiwan has made changes to its laws on estates and gifts, land rights, and types of taxes.<sup>179</sup> This effort has brought coherence to the law and made it clear how the trust form can be used and what its implications are for various legal relations.<sup>180</sup> China could use this avenue of reform not only to make civil trusts possible, but to encourage their use by giving such trusts certain advantages over traditional investments. For example, donations to certain pooled trusts could be made tax deductible,<sup>181</sup> or real property law could allow for a joint tenancy or other property right to become part of trust assets.

Finally, the development of trusts could be accelerated by explicitly granting Chinese courts the power to develop doctrine in the area, essentially creating a limited common law regime within China's civil law system. This may in fact arise as a matter of practice even if statutory reforms do not materialize; courts may realize that civil trusts are valuable enough that they may be willing to stretch or ignore the formal rules in order to accommodate them. However, this sort of wink-wink, nudge-nudge accommodation can only go so far. It could never result in the comprehensive system of clear, consistent rules that is necessary for full development of civil trusts. Explicitly granting power to courts to develop and change doctrine in the area of trusts would be an easy way to defer the resolution of some problems but still maintain stability and consistency of enforcement.

In short, there are at least three types of trusts that need to be distinguished and facilitated: commercial trusts, pooled civil trusts, and individual civil/family trusts. Modest reform to the current regulations could provide a legal basis for these distinctions. However, the more these distinctions are fleshed out, the more secure the future of Chinese trusts will be. The best-case scenario is a full-fledged regime of laws and regulations for each type of trust, as well as granting courts the power to develop the doctrine for each. If such an overhaul is impossible, however, anything that makes these distinctions clear

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<sup>179</sup> Wen-Yeu et al., *supra* note 173, at 66.

<sup>180</sup> *See id.* at 65–67 (showing how Taiwanese trust law has developed so that it can be clearly divided into three areas: individual and charitable trusts; business and commercial trusts; and the design of trust products and the taxation of trusts).

<sup>181</sup> Chinese law currently gives no tax benefit to any trust forms, including testamentary trusts, thereby seriously discouraging their use even if they were theoretically possible. *See* Gao, *supra* note 66, at 357 (“The current Chinese tax law does not provide any benefit to trusts, and trusts are not even recognized as an income conduit to avoid entity-level taxes.”).

will allow Chinese citizens to better take advantage of the trust form to promote their own best interests.

Thus, although the thorough path of comprehensive reform would be ideal, luckily the easy path and the thorough path are not mutually exclusive. If the CBRC takes even the modest step of clarifying the commercial/civil distinction in its regulations, this will not only allow some civil trusts, it will also incentivize the legislature to think more critically about the non-financial uses of trusts, and perhaps inspire it to pursue more comprehensive legal reforms.

#### CONCLUSION

By overhauling the legal regime governing trusts, China can place both its commercial and civil trusts on a firm foundation. In doing so, it can either follow the model of other Asian jurisdictions or become a leader in its own right by looking to the future of trusts rather than simply responding to demands as they arise.

To catch up to other Asian countries such as Japan, Taiwan, and South Korea, China needs only to distinguish between commercial and civil trusts and clarify general issues such as ownership rights and means of redress. To truly be a leader in the legal development of trusts, however, China must do more. By adopting administrative regulations to facilitate certain types of civil trusts, including family trusts and collective trusts for old or disabled beneficiaries, China could set a new model for the rest of Asia. These regulations could be modeled on those of any U.S. state and would be quite simple to devise. Though it would require research and effort to determine the appropriate regulations, such groundbreaking reform would set China's trusts on a much firmer footing. Most importantly, it would allow families to more effectively plan for their own futures and put China's private sector to work in caring for the country's most vulnerable populations. Mrs. Wang and millions of others are ready and willing to provide for the needs of their family. They need only the legal means to do so.