

Dilemmas and Responses to the Failure of Prompt Corrective Action by the Deposit Insurance Agency

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Abstract: China has proposed “establishing a binding system for Prompt Corrective Action to deal with financial risks”. As a core component of Prompt Corrective Action, China’s current deposit insurance system is confronted with the dilemma of insufficient capacity to deal with financial risks. The primary causes lie in the ambiguous legal status of the Deposit Insurance Agency, the unclear division of powers and responsibilities between the Deposit Insurance Agency and other regulatory authorities, and a lack of necessary powers for the Deposit Insurance Agency. Legislation should define the legal status of the Deposit Insurance Agency as an independent regulatory authority, delineate the boundaries of responsibilities between the Deposit Insurance Agency and banking supervisors in the process of early risk identification and resolution, and grant the Deposit Insurance Agency powers to obtain information, conduct bank examinations, issue risk warnings, adjust insurance premium rates, and recommend early corrective actions to banking supervisors.

Keywords: Financial Risk Prevention and Control; Deposit Insurance System; Prompt Corrective Action; Financial Regulation; Financial Stability Law

1. Introduction

China has proposed “establishing a binding system for Prompt Corrective Action to deal with financial risks”. Prompt Corrective Action (PCA) refers to a system under which regulatory authorities promptly identify risks of financial institutions and adopt measures based on the risk level of such institutions before their problems deteriorate. In China, the Prompt Corrective Action was initially stipulated in the *Deposit Insurance Regulation*, and later, the *Commercial Bank Law (Draft Amendment)* and the *Financial Stability Law of the People's Republic of China (the second review draft)* also regulated Prompt Corrective Action, thereby establishing a framework where multiple financial regulatory authorities participate in such regulation. However, the existing laws are general and lack clear authorization for regulators, leading to buck-passing among regulatory authorities, thereby undermining the function of the Prompt Corrective Action. As a core entity to control financial risks, the Deposit Insurance Agency also struggles with the ineffective implementation of Prompt Corrective Action. ^[1]Accordingly, it is essential to clarify the role of the Deposit Insurance Agency in Prompt Corrective Action, delineate the boundaries of powers and responsibilities between the Deposit Insurance Agency and other financial regulatory institutions.

2. The Rationale for Prompt Corrective Action by the Deposit Insurance Agency

Establishing a binding regime for Prompt Corrective Action is a pivotal strategic deployment to fortify the financial risk prevention and control system. As the core entity in risk management, the Deposit Insurance Agency plays a vital role in PCA, which is of great significance for Chinese modernization.

2.1 Risk Prevention as a Safeguard for Chinese Modernization

The Third Plenary Session of the 20th CPC Central Committee underscored that high-quality development is the primary task in building a modern socialist country. Since the reform and opening-up, China has undergone a profound socioeconomic transformation from the absence of private wealth

to rapid accumulation and notable stratification of household assets.^[2] The gaps of imbalanced regional development and excessive individual income disparity need to be bridged through high-quality development, in which finance plays a critical role. Finance facilitates maturity matching and optimizes resource allocation, thereby curbing income polarization, and advancing common prosperity. In addition, a diversified and specialized financial system—encompassing tech finance, green finance, inclusive finance, pension finance, and digital finance—forms an integral part of the modern financial system and provides robust underpinnings for strengthening the China's economic power. Moreover, finance facilitates the upgrading of industry through offering financial services to economic activities that enhance environmental quality, address climate change, and improve economic efficiency.

The promotion of high-quality development through Chinese modernization must be based on financial security. Currently, China has entered a phase where strategic opportunities coexist with risks and challenges. Inadequate mitigation of financial risks can give rise to severe bad consequences. On the one hand, financial crises carry a domino effect: risks emerging within individual institutions tend to amplify and spill over into other financial entities and eventually trigger systemic financial risk. On the other hand, the failure of financial institutions disrupts payment systems, freezes debtors' assets, and impairs their ability to perform contractual obligations. This further disturbs the settlement of bills and credit card transactions, severely eroding the credit system. As a result, financial consumers become reluctant to save or invest, firms face acute financing illiquidity, and productive activities are suppressed. Accordingly, financial risks pose a threat to high-quality development of Chinese modernization. Preventing and controlling financial risks constitute a critical hurdle that must be overcome to achieve high-quality development.^[3]

2.2 The Importance of Prompt Corrective Action in Risk Control

Traditional risk management frameworks primarily prioritize ex-post compensation after the infringement of legal interests, which gives rise to numerous drawbacks.^[4] On the one hand, it incurs substantial social costs. The failure of financial institutions often triggers a “domino effect” and a “run effect,” allowing crises to spread to other market participants through credit chains, causing market chaos and exerting extremely strong negative externalities on society.^[5] On the other hand, ex-post risk management entails irreversible damage. If financial security is damaged, it will not only result in the loss of property but also deprive the country of its voice in the international financial market. Legislators should adhere to the legal philosophy that “ex-ante prevention is superior to ex-post remedy,” and promptly prevent and resolve risks before the bankruptcy of financial institutions. The Prompt Corrective Action is precisely an effective embodiment of identifying and addressing risks at an early stage.

The Prompt Corrective Action (PCA) originated from *the U.S. Federal Deposit Insurance Corporation Improvement Act of 1991* (FDICIA). Based on capital adequacy, the Act stratifies banking institutions into five regulatory categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. It further empowers the Deposit Insurance Agency to intervene timely and implement measures to restore a bank's operational ability. Once an institution descends into a “critically undercapitalized” state, regulators are mandated to initiate receivership and adopt diverse resolution tools—such as bridge banks and Purchase and Assumption (P&A) agreements—to resolve institutional risks.^[6] This legislative precedent from the United States has served as a global benchmark for banking law reform. While the frameworks of deposit insurance law vary across jurisdictions, the universal essence of PCA remains constant: supervisors adopt differentiated risk resolution measures based on the level of bank's risk. This framework aims to improve banks' operational conditions before their conditions deteriorate.

The significance of Prompt Corrective Action (PCA) manifests in three dimensions. First, it promptly deters excessive risk-taking by financial institutions. If regulatory authorities take measures until a financial institution is on the verge of insolvency, the costs are inevitably externalized to other creditors, which exacerbates the moral hazard. Conversely, the PCA compels financial institutions to proactively rectify deficiencies before their conditions deteriorate. Furthermore, this framework significantly mitigates risk resolution costs. Even if a financial institution is ultimately subjected to receivership or liquidation, early regulatory intervention—initiated while the institution still retains a positive net worth—ensures that the institution's own equity capital absorbs a portion of the losses. Consequently, this proactive approach minimizes the financial burden imposed on public funds during the resolution process. Third, a mandatory PCA regime curtails regulatory forbearance. Regulatory discretion regarding the necessity, timing, and methodology of intervention frequently leads to delayed risk management, which can induce systemic crises. By enforcing statutory constraints, the PCA requires regulators to execute corrective measures at the early stages of financial distress and thereby systematically

dismantling regulatory forbearance.^[7]

2.3 The Significance of Prompt Corrective Action by the Deposit Insurance Agency

China has established a new financial regulatory paradigm. Under this framework, the Central Financial Commission and the Central Financial Work Commission provide overall coordination, while the People's Bank of China (PBOC), the National Financial Regulatory Administration (NFRA), and the China Securities Regulatory Commission (CSRC) serve as the primary executive entities. According to Tinbergen's Rule, achieving multiple policy objectives requires diverse policy instruments.^[8] If the PBOC and the NFRA were required to assume both PCA and their respective objectives, the conflict would undermine regulatory efficiency. In contrast, equipping the Deposit Insurance Agency with the power for PCA can mitigate these frictions and enhance overall regulatory efficacy.

There exists an inherent tension between the role of PBOC's macro-prudential regulation and the Prompt Corrective Action. The current institutional reform aims to strengthen the macro-prudential regulation of PBOC. Conversely, PCA is a micro-prudential supervision, which focuses on the idiosyncratic safety of financial institutions. It mandates that individual banks maintain key metrics—such as leverage, capital adequacy, and provision coverage ratios—within prescribed thresholds to ensure operational soundness.^[9] Should the PBOC prioritize PCA, it would deviate from its macro-prudential objectives, particularly in the realm of monetary policies. For instance, when a financial institution faces insolvency, the PBOC might provide liquidity support; however, against a background of excess market liquidity, such support would directly contravene the central bank's core goal of maintaining price stability.

Secondly, if the NFRA assumes PCA alone, the issue of regulatory forbearance will arise. The potential risks of rent-seeking, principal-agent problems, will result in regulatory failure.^[10] The Economic Theory of Regulation posits that regulators are not purely altruistic; they consider self-interest during policy execution, which may not align with the public interest.^[11] Given the technical complexity of risk governance, regulators may steer interventions toward their own "preferences" or even conceal risks of financial institutions, thereby exacerbating systemic vulnerabilities.

Equipping the Deposit Insurance Agency with the Power of PCA serves as an effective mechanism to rectify above flaws. This efficacy stems from the endogenous incentives inherent to the Deposit Insurance Agency. The financial health of insured banks is linked to the interests of the Deposit Insurance Agency. In the event of a bank failure, The Deposit Insurance Fund (DIF), accumulated by the Deposit Insurance Agency to address financial risks, must bear substantial costs for insurance payouts. A rational Deposit Insurance Agency will solve problems proactively, mitigating risks at an early stage to minimize potential costs. Thus, focusing on the idiosyncratic risks of insured banks addresses the conflict faced by the PBOC. Furthermore, motivated by risk mitigation imperatives, the Deposit Insurance Agency possesses a stronger incentive to identify vulnerabilities and implement prompt corrective action, thereby effectively curbing the regulatory forbearance typically associated with the NFRA.

3. Dilemmas Faced by the Deposit Insurance Agency in Prompt Corrective Action

Under the current legislative framework, the Deposit Insurance Agency confronts substantial legal impediments to adopting effective measures.

3.1 Ambiguous Legal Status of the Deposit Insurance Agency

Prompt Corrective Action inherently possesses the attributes of public power, extending beyond the scope of intervention in a relationship between a commercial insurer and the insured. However, PCA initiated by a commercial entity lacks the binding force over banks. The existing legislation fails to articulate the Deposit Insurance Agency's legal status. Article 7 of *the Deposit Insurance Regulation* vaguely stipulates that the "entity of the deposit insurance fund shall be prescribed by the State Council," leaving its legal characterization unsettled. Is the Deposit Insurance Agency a public law entity vested with regulatory authority, or a private law entity characterized by profit-seeking motives? If defined as a public authority, does it maintain a horizontal relationship with other financial regulatory departments, or is it positioned within a hierarchy of administrative subordination?

China has incorporated the Deposit Insurance Fund Management Co., Ltd. (DIFM) to undertake the statutory functions of deposit insurance. The Deposit Insurance Fund Management Co., Ltd. (DIFM)

adopts the organizational form of a for-profit limited liability company under private law. Yet unlike conventional profit-maximizing enterprises, the DIFM is mandated to safeguard depositor interests, foster banking stability, and maintain financial order which renders it a quasi-public good rather than a private commercial entity. The DIFM's senior management consists of officials from the People's Bank of China (PBOC), reflecting its subordination to the central bank. This tension between the external for-profit corporate form and the internal mission of preserving financial stability has generated debate over whether the Deposit Insurance Agency constitutes public or private law subjects.

If the Deposit Insurance Agency is legally classified as a public authority, its relationship with other financial regulatory agencies requires precise delineation. The senior management of the Deposit Insurance Fund Management Co., Ltd. is entirely from the People's Bank of China (PBOC), which makes the deposit insurer a subordinate adjunct to the central bank. However, as previously discussed, the People's Bank of China mandates macro-prudential regulation, whereas the Deposit Insurance Agency focuses on the micro-level regulation of individual insured banks. Consequently, subsuming the Deposit Insurance Agency under the PBOC's jurisdiction creates a structural misalignment.

3.2 Ambiguous Allocation of Responsibilities Between the Deposit Insurance Agency and Other Regulatory Authorities

China's Deposit Insurance Regulation (Article 7), *the Commercial Banking Law* (the draft amendment) (Article 90), and *the Financial Stability Law* (the second draft) (Article 18) respectively empowers the Deposit Insurance Agency, banking regulatory authorities, and central financial regulators with convergent powers regarding Prompt Corrective Action (PCA). However, existing legislative frameworks merely instruct that "relevant authorities shall adopt early corrective measures" without delineating jurisdictional boundaries among regulators. This legislative ambiguity generates functional overlap, induces regulatory buck-passing, and creates regulatory vacuums.

A comparative legal analysis reveals that the PCA typically comprises two phases: early identification and early intervention. Early identification encompasses the processes through which regulators conduct risk monitoring, risk rating, and early warning to distress banks. Early intervention denotes the implementation of corrective measures against troubled banks. Risk represents an imminent threat that has not yet crystallized into actual harm. The Deposit Insurance Agency must therefore intervene promptly to prevent risk transmission.^[12] Regulatory interventions must be calibrated against the risk levels of banks: while routine supervision is appropriate for low-risk entities, intensified intervention is necessary for high-risk institutions.

The precise role of the Deposit Insurance Agency during the early identification phase remains legally ambiguous. Regarding the allocation of regulatory responsibilities during the early identification phase, a comparative legal analysis reveals that in the United States, the Deposit Insurance Agency is primarily responsible for prompt corrective action (PCA). Financial Laws grant this agency comprehensive powers over monitoring, early warning, and early intervention.^[13] By contrast, Canada and South Korea generally entrust PCA to their financial regulatory agencies. For instance, Article 10(1) of *South Korea's Act on the Structural Improvement of the Financial Industry* stipulates that if a financial institution's capital adequacy ratio falls below a specific threshold, or if its financial condition fails—or is evidently likely to fail—to meet prescribed regulatory standards, the Financial Services Commission (FSC) may advise, request, or order the financial institution to take various measures to prevent operational deterioration.^[14] In China, current legislation fails to expressly stipulate the functional mandate of the Deposit Insurance Agency, an ambiguity that remains to be clarified.

The allocation of resolution responsibilities between the Deposit Insurance Agency and banking regulators also requires precise delineation. PCA encompasses minor interventions, such as issuing risk warnings, conducting supervisory interviews with the board of directors or senior management, and mandating the submission of capital management plans; intermediate restrictions, such as ordering banks to replenish capital, limiting guaranteed liabilities, restricting dividends and other distributions; and the most severe restrictions, such as suspending business operations, and mandating the write-down or conversion into common equity of all tiers of capital instruments. Throughout the resolution process, the delineation of resolution responsibilities between the Deposit Insurance Agency and banking regulators constitutes a critical legislative challenge requiring immediate redress.

3.3 Insufficient Regulatory Powers of the Deposit Insurance Agency

Current Chinese legislation fails to adequately delegate statutory powers to the Deposit Insurance

Agency, thereby undermining the overall efficacy of the PCA framework.

First, from a legislative perspective, PCA is framed as a permissive rather than a mandatory provision. Relevant statutes—such as the *Deposit Insurance Regulation, the Commercial Bank Law (Draft Amendment)* and the *Financial Stability Law of the People's Republic of China (the second review draft)*—predominantly use the permissive term "may" instead of the imperative term "shall" when authorizing PCA. This deprives PCA of its legally binding force. For instance, when a bank experiences distress, regulatory bodies retain broad discretion to either initiate or forgo intervention, diluting the mandatory binding force of the PCA framework.

Second, the scope of the Deposit Insurance Agency's statutory powers is excessively narrow. Article 15 of the *Deposit Insurance Regulation* authorizes the agency to issue risk warnings to insured banks, while Article 16 permits appropriate premium increase for banks failing to implement required rectifications. Regarding risk warnings, the current legislative framework lacks explicit stipulations concerning the timeframe and efficacy of bank remediation, which impedes the enforcement of the law. Similarly, increasing premium rates also has proven insufficient to exert adequate binding force on banks. Banks may adopt a speculative "gambling" mindset, opting to pay higher regulatory premiums in exchange for pursuing high-risk business ventures. Beyond warnings and premium adjustments, current PCA does not impose restrictions on shareholders, directors, and senior management. Indeed, under the doctrine of limited liability, banks can externalize the commercial risks of operational failure to creditors. Meanwhile, shareholders are incentivized to engage in risk-taking behavior due to the divergence between residual risk exposure and residual claim rights.^[15] Furthermore, executive performance appraisal systems often compel management to prioritize short-term profitability at the expense of long-term stability, thereby fostering speculative management.^[16]

Deficient statutory authority hinders the Deposit Insurance Agency's ability to initiate Prompt Corrective Action (PCA). Consequently, even when invoked, these measures lack the teeth to constrain troubled banks, rendering the PCA framework a regulatory impasse.

4. Resolving the Dilemma of Ineffective Prompt Corrective Action by Deposit Insurance Agencies

To rectify the operational failures of Prompt Corrective Action (PCA) within deposit insurance frameworks, this study proposes the following legislative refinements.

4.1 Clarifying the Legal Status of the Deposit Insurance Agency

Statutory frameworks should designate the Deposit Insurance Agency as a public authority. This ensures that its Prompt Corrective Action constitutes legally binding administrative acts, thereby exerting enforceable constraints on distressed banks. The dichotomy between public and private law originates from the Roman jurist Ulpian, who defined public law as the relationship between the state and its citizens, while private law pertains to individual interests.^[17] Subsequent theoretical developments concerning the public-private law distinction have yielded purposive, relational, subject-based, and substantive doctrines. The prevailing consensus favors an eclectic approach that synthesizes regulatory objectives, the participation of state actors, and hierarchical asymmetry within legal relations.^[18]

From a teleological perspective, deposit insurance is conceived to safeguard financial security. Given that providing security constitutes the ontological justification for the state's existence—with financial security being a core pillar of national security—the state bears an inherent and paramount responsibility for its maintenance.^[19] Consequently, vesting the Deposit Insurance Agency with Prompt Corrective Action (PCA) authorities serves as a concrete manifestation of state governance. This represents an exercise of public administrative power over the socio-economic sphere.

An examination of the legal relationship between the Deposit Insurance Agency and banks reveals that the deposit insurance contract deviates significantly from the principle of freedom of contract and is not predicated on party autonomy. To mitigate severe information asymmetry in financial markets and safeguard financial stability, China has implemented a mandatory deposit insurance regime. Furthermore, the resolution of insured banks by the Deposit Insurance Agency reflects an asymmetrical relationship. The agency's risk resolution measures are inherently unilateral; insured banks have no right to reject the resolution, which is exclusively determined by the agency.^[20] Thus, the resolution of failing banks is rooted in explicit statutory mandates rather than contractual freedom.

The preceding analysis demonstrates that deposit insurance contracts are essentially administrative

in nature, as they consider public interests, confer a manifest advantage upon the regulatory party. Thus, the Deposit Insurance Agency functions as a public authority. Its implementation of Prompt Corrective Action (PCA) constitutes a legally binding administrative act, imposing enforceable constraints on failing banks.

Concerning the relationship between the Deposit Insurance Agency and other financial regulators, this paper advocates for establishing the agency as an independent financial authority. It should operate alongside the People's Bank of China (PBOC) and the National Financial Regulatory Administration (NFRA) on a coordinate, rather than subordinate, basis. As previously discussed, conflicts of interest inevitably arise when different regulators pursue distinct policy objectives. Subordinating the Deposit Insurance Agency to a specific department reduces it to appendage, failing to resolve inherent structural conflicts.

4.2 Delineating Regulatory Boundaries Between the Deposit Insurance Agency and the NFRA

4.2.1 Allocation of Responsibilities for Early Detection

Early detection entails risk monitoring, rating, and early warning. The Deposit Insurance Agency and the NFRA should jointly establish the risk-rating criteria while maintaining independent monitoring and early warning operations. Rulemaking invariably redistributes societal interests and incurs administrative costs.^[21] The bank risk-rating model should be co-determined by the Deposit Insurance Agency and the NFRA. The reasons are as follows:

First, joint formulation prevents regulatory capture stemming from the concentration of power. Regulatory outcomes inherently alter stakeholder interests, incentivizing entities to influence the rulemaking process. As public choice theory suggests, interest groups seek to maximize their utility through political mechanisms;^[22] thus, regulatory decision-making is fundamentally a bargaining process among groups striving to advance their own interests. Since risk assessment and early warning frameworks directly affect the core interests of banks, delegating unilateral rulemaking authority to a single agency creates an institutional monopoly. Consequently, joint rulemaking is essential to mitigate regulatory capture. Second, joint formulation conserves regulatory resources. Given the finite nature of legislative and administrative resources, their allocation demands prudent planning and efficient utilization. Developing sophisticated risk-rating and early warning mechanisms entails significant capital and intellectual investment. These frameworks rely on extensive empirical research, and inter-departmental deliberation, all of which are resource-intensive.^[23] By collaborating on a unified set of risk-rating criteria, the Deposit Insurance Agency and the NFRA can optimize resource allocation, avoid duplicative regulatory efforts, and enhance the regulatory capacities, thereby reducing overall administrative costs. Furthermore, it provides banks with definitive guidance, allowing them to calculate risk metrics based on a single unified standard rather than complying with requirements from multiple regulators.

4.2.2 Allocation of Responsibilities for Early Resolution

Early resolution represents the stage during which regulatory authorities impose additional restrictive measures on banks. It is more rational for the National Financial Regulatory Administration (NFRA) to implement measures directly restricting a bank's operational rights, whereas the Deposit Insurance Agency is suitable for taking measures concerning the interests of the deposit insurance fund.

The intensity of regulatory intervention depends on the bank's risk status. When the risk is relatively low, regulators typically take measures such as issuing supervisory warnings, conducting regulatory meetings with the board of directors or senior management, and mandating the submission of capital management plans. If the risk escalates, corrective actions must be intensified—for instance, requiring timely capital replenishment, restricting dividend payouts and other income, and curbing incentive compensation for directors and senior executives. Should a bank deteriorate into a high-risk state, regulators must invoke more stringent interventions, including, but not limited to, removing the management team, suspending specific business operations, mandating the write-down or conversion of loss-absorbing instruments into common equity, and restricting surplus distribution.

As these measures demonstrate, an escalating risk profile triggers increasingly severe regulatory constraints that may ultimately jeopardize a bank's viability. Since the NFRA holds exclusive authority over licensing and market exit, it is legally consistent for this body to enforce measures that directly impinge upon a bank's operational rights—such as dividend restrictions, asset growth caps, forced divestitures, and business suspensions. Conversely, interventions linked to the deposit insurance fund,

notably premium adjustments, fall under the sole mandate of the Deposit Insurance Agency. Furthermore, because early interventions (e.g., warnings, management interviews, and capital planning) do not threaten a bank's going-concern status, they may be concurrently administered by both the Deposit Insurance Agency and the NFRA.

4.3 Expanding the Statutory Powers of the Deposit Insurance Agency

4.3.1 The power of Acquiring Information

Acquiring reliable information is critical for precise risk assessment. Decisions made in the absence of sufficient data inevitably lead to misguided regulatory actions. The Deposit Insurance Agency acquires information through two primary channels: direct collection from financial institutions and indirect acquisition from other regulatory authorities.

Regarding direct collection, legislation must explicitly grant the Deposit Insurance Agency the statutory right to collect necessary information from banks. Given the complexity and volatility of financial risks, coupled with the inherent limitations of legislative foresight, statutes should avoid exhaustively enumerating information types. Instead, they should grant the agency discretionary power to collect relevant data from banks. Notably, the Deposit Insurance Agency must strictly adhere to the principle of proportionality. Information collection must be strictly confined to risk prevention purposes and must not exceed necessary limits.

Regarding indirect information acquisition, establishing an information-sharing mechanism is indispensable.^[24] In the absence of such arrangements, it is exceedingly difficult for any single authority to construct a whole view of a bank's risk status. Therefore, creating a platform to facilitate information exchange and knowledge sharing constitutes a crucial component of financial risk rating. To fortify information-sharing capabilities, China's *Financial Stability Law (Second Draft for Review)* proposes an information-sharing mechanism, mandating the People's Bank of China (PBOC) to lead the development of a unified database. To ensure operational efficacy, this platform must standardize data dissemination through unified protocols and formats.

Furthermore, non-compliance with reporting obligations entails statutory sanctions. Specifically, the Deposit Insurance Agency is authorized to increase deposit insurance premium rate. This is predicated on the logic that a bank's refusal or failure to provide requisite information triggers elevated risk status. Under a risk-based premium framework, the Deposit Insurance Agency is legally empowered to levy higher premiums on such high-risk institutions.

4.3.2 The Power of Examination

Relying on historical data to assess a bank's contemporaneous risk profile inherently entails regulatory lag. Therefore, granting the Deposit Insurance Agency the power of examination is paramount for ensuring the accuracy of risk evaluations. To address these challenges, this study proposes that China's legal framework be refined in the following dimensions:

First, explicitly granting the Deposit Insurance Agency the right to examine. To effectively mitigate banking risks, the authority must be vested with the power to conduct examinations both at the pre-contractual phase and throughout the tenure of the deposit insurance relationship. Second, delineating the subjects of examination. The primary subjects are insured institutions, namely banks. Beyond the banks, foreign statutes often grant deposit insurance agencies the power to investigate or examine the affiliates and related parties of insured institutions. These related parties encompass financial institution executives and employees, affiliated enterprises, and mutually invested companies. China is advised to encompass related parties within the scope of examination. This inclusion not only facilitates a more precise assessment of a bank's risk level but also imposes constraints on related parties—such as directors, senior executives, and shareholders—thereby curbing the moral hazard of bank stakeholders. Third, standardizing the methods of examination. Examination methods are categorized into on-site and off-site examinations. During on-site examinations, the Deposit Insurance Agency may require the attendance of bank personnel and related parties for testimony or the disclosure of financial records. For off-site monitoring, the agency reserves the right to mandate the submission of materials for risk evaluation. In both instances, the bank and its key personnel are bound by an affirmative obligation to provide accurate and truthful disclosures.^[25]

4.3.3 The Power of Issuing Risk Warnings

Should a bank's risk escalate significantly, the Deposit Insurance Agency is authorized to issue a risk

warning and mandate prompt corrective action within a prescribed timeframe. Applicable supervisory measures include issuing risk notices, holding regulatory interviews with the board of directors or senior management, and compelling the submission of capital management plans. Crucially, to ensure the substantive efficacy of these warnings, the deposit insurer must clearly define both the compliance deadlines and the expected rectification outcomes.

4.3.4 The Power of Increasing Premium Rates

China's deposit insurance system employs a risk-based premium framework to enforce risk-control discipline and curtail cross-subsidization. Under this mechanism, any failure to implement prompt corrective action or meet supervisory requirements triggers an escalation in a bank's risk rating. This enables the deposit insurer to impose elevated premium rates on recalcitrant banks, effectively utilizing financial disincentives to forestall systemic risks.

4.3.5 The Power of Recommending Prompt Corrective Action to the Banking Regulator

Legislative reform should authorize the Deposit Insurance Agency to propose prompt corrective action (PCA) to the NFRA, thereby enhancing the DIA's enforcement capacity while ensuring regulatory accountability. While the NFRA should, in principle, adhere to these recommendations, an institutional reconciliation mechanism is essential to mitigate inter-agency friction. Pursuant to Article 5 of the Financial Stability Law (Second Draft), which tasks the central financial leadership body with high-level coordination, this entity is the most appropriate arbiter for resolving jurisdictional disputes. [26]By establishing a formalized dispute-resolution platform, this central body can provide the regulatory certainty necessary to stabilize market expectations.

5. Conclusion

This study identifies systemic vulnerabilities in China's Prompt Corrective Action (PCA) framework, stemming primarily from the Deposit Insurance Agency's (DIA) institutional constraints. The current PCA mechanism is severely undermined by the DIA's ambiguous legal characterization, jurisdictional overlaps with banking supervisors, and a critical deficit in mandatory enforcement powers. To address these issues, legislative reform must establish the DIA as an independent public authority, ensuring its early interventions constitute legally binding administrative acts. Furthermore, a dual-track regulatory architecture is necessary to delineate a collaborative approach for early risk identification, while separating early resolution duties between the DIA and the National Financial Regulatory Administration (NFRA). Crucially, the regulatory vacuum must be closed by expanding the DIA's statutory toolkit to include comprehensive information access, related-party examinations, binding risk warnings, premium surcharges, and the formal authority to recommend corrective actions to banking regulators.

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