Breaking the Path Dependency and Reconstructing the Investment in Non-Performing Assets in China: A Perspective of Financial Asset Management Companies

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Abstract. Financial Asset Management Companies (AMCs) play a pivotal role in China's economic development, serving as agents of "revitalization and recovery" and "assistance in crisis." Since the establishment of the four major state-owned AMCs, and with the China National Financial Regulatory Authority approving the creation of "Galaxy Asset" in 2020, the total number of state-owned AMCs has grown to five. After more than two decades of development, these institutions now face unprecedented challenges. Confronted with the complexities of the non-performing asset (NPA) market, the critical question is how these AMCs can fulfill their mandate to rescue market entities while ensuring their own operational security. This study reviews the historical evolution of AMCs and analyzes the current market conditions, arguing that the five state-owned AMCs should leverage their unique roles and identities to contribute differently to the NPA market. By doing so, they can ensure market order and stability while achieving sustainable and healthy development.

Keywords: Asset Management Companies; Market Entities; Policy-Oriented AMC; Market-Driven AMC.

1. Introduction

China's financial asset management industry has undergone more than two decades of continuous exploration, innovation, and practice. The disposal of non-performing assets has experienced multiple adjustments and transformations in terms of targets, methods, and mechanisms. The functions and positioning of financial asset management companies ("National AMCs") have also undergone significant changes in both theory and practice. During the policy-based disposal phase, the core business goal of the four major AMCs focused on preserving assets as much as possible and reducing losses. Their business focus was primarily on the disposal of policy-based non-performing assets. The disposal methods adopted during this phase were relatively simple and broad, mainly relying on the "three Ds" strategy: packaging, discounting, and litigation. The functional positioning was relatively singular. During the subsequent commercialization transformation process, the four major financial asset management companies became self-financing, shifting from a focus on the policy-based preservation of banking non-performing assets to profit maximization in non-performing asset operations, while also expanding into non-financial sectors such as acquisitions and restructuring. However, this transformation triggered phenomena such as deviation from the real economy and "off-balance-sheet" practices. The intertwining of policy and commercial goals caused non-performing asset acquisitions and disposals to gradually deviate from their original function of mitigating financial risks and serving the real economy. In 2018, the exposure of the Lai Xiaomin case gradually revealed the risks accumulated during the transformation of financial asset management companies. These risks included the blurred boundaries between policy-based and commercial activities, unclear responsibilities, and functional confusion. At the same time, regulatory authorities began to pay attention to the various challenges financial asset management companies faced during their commercialization transformation. The 20th National Congress report of the Communist Party of China deeply discussed the unique characteristics, essential requirements, and important significance of Chinese-style modernization, providing fundamental guidelines for the economic and financial work of the new era. Financial asset management companies need to leverage their advantages and accurately position their development direction, fully utilizing their functions in the context of building a modern socialist country. In the new phase of focusing on core business, financial asset management companies have returned to a counter-cyclical rescue function, terminated the development strategy aimed at building financial holding groups, actively reduced non-core financial licenses, and explored "large non-performing" businesses focusing on "restructuring, reorganization, and reconstruction," while actively playing the role of financial rescue and value revitalization.

From a historical development perspective, there are differences in the functional positioning and operational practices of financial asset management companies across countries. When China's financial asset management companies were first established, they primarily referred to the successful practices and experiences of international society in disposing of banking non-performing assets. During the 1990s financial crisis, the United States established the Resolution Trust Corporation (RTC) to resolve the risks of thrift institutions, pioneering the development of non-performing asset markets. Sweden established the separation mechanism of "good bank" and "bad bank" through Securum, setting a model for the disposal of non-performing assets. During the Asian financial crisis, Japan followed the RTC model and established the Housing Loan Corporation and the National Reorganization and Recovery Corporation (RCC); South Korea established the Korea Asset Management Corporation (KAMCO) through the restructuring of the Industrial Bank, effectively reducing the ratio of non-performing loans and improving the credit ratings of financial institutions. Malaysia established Danaharta, which achieved remarkable results through legislative action, classified management, and enhanced market incentives. India specifically established the Asset Reconstruction Company (Arcil) to focus on addressing non-performing asset issues. China’s four major financial asset management companies were also born during this period. Theoretical research shows that the establishment of financial asset management companies aims to assist the government in addressing systemic financial risks after a financial crisis [1]. Byrne (2015) further argued that financial asset management companies are one of the important policy tools for governments to handle financial crises [2]. After the financial crisis, as the industry entered an innovative development phase, the United States launched the Troubled Asset Relief Program (TARP) and the Public-Private Investment Fund (PPIF) to clear non-performing assets from the financial system; Ireland’s National Asset Management Agency (NAMA) made large-scale acquisitions of non-performing assets; Switzerland's central bank established the special purpose vehicle StabFund to provide loans to UBS for acquiring non-performing assets; and Italy introduced the Atlantia rescue fund model in 2016, combining government credit with market mechanisms to effectively promote the disposal of non-performing assets. After experiencing the challenges of commercialization and disorderly development, China issued the fifth national financial asset management company license in 2020, aiming to refocus on core responsibilities and explore a new development path suitable to its national context. This shift marks an attempt to refocus the core functions of China's financial asset management companies.

From the historical development trajectory of financial asset management companies in various countries, their functional positioning typically follows two paths: commercialization transformation and policy-based operations. Theoretically, some scholars suggest that a sound financial system should include policy-based finance as a parallel and complementary component to commercial finance [3]. Other scholars emphasize the necessity of clearly defining the distinction between policy-based business and commercial business [4]. However, regarding the future development direction of China's financial asset management companies, there has been longstanding disagreement in academic circles. Especially before 2018, most opinions leaned toward a commercial development model. Some argued that a comprehensive financial asset management company was the best option [5]. Other scholars suggested exploring three paths: holding companies, investment banks, and debt banks [6]. However, in recent years, the issues of blurred functional positioning and operational disorder in the commercialization transformation have gradually emerged, leading some scholars to favor a policy-based financial orientation. Some scholars advocate drawing lessons from Singapore’s Temasek model to re-define the functional positioning of China's financial asset management companies, better addressing the complex challenges in state-owned enterprise reform and management [7]. Others, based on financial development and financial intermediation theories, argue that financial asset management companies have both "institutional functions" in a practical sense and "shareholder functions" in a normative sense, with their policy-based characteristics being more prominent under the influence of national policies [8]. Scholars such as Bai & Zhang (2022) [9], and Jiang (2022) [10] have also clearly pointed out that China's financial asset management companies should perform policy-based financial functions and be classified as policy-based non-bank financial institutions. From a practical perspective, financial asset management companies in China still face significant uncertainty regarding their functional positioning. On the one hand, their current operating models and core functions deviate to some extent. On the other hand, it remains unclear whether they should be defined as a purely policy-based financial institution, a fully commercialized financial enterprise, or a comprehensive financial services entity with both functions. This ambiguous positioning not only affects the formulation of their strategic goals but also presents challenges for choosing their future development path.

From the historical process of the different stages of financial asset management companies and the theoretical differences in academic circles, it can be seen that the state has exhibited a certain "trial-and-error" approach in promoting the commercialization transformation of financial asset management companies. However, while striving to achieve reform objectives, the state has always sought to maintain control over the policy-based functions of financial asset management companies. This process reveals the complex mentality of "crossing the river by feeling the stones" in China's reform of financial asset management companies. From both historical and current perspectives, China's financial asset management companies have long assumed policy-based financial functions, and this positioning has determined that they are always subject to strict regulation. Acknowledging this, it becomes evident that from the very beginning, the commercialization reform inevitably encountered the "marketization paradox"—seeking both market-oriented operations and policy-based goals, which are difficult to reconcile [11]. The theoretical debates and institutional design issues surrounding commercialization versus policy-based paths have once again attracted widespread attention from regulatory authorities and academia. The key questions of how to balance "commercialization" and "policy-based" goals, whether the functions of financial asset management companies need to be redefined, and what transformation paths to choose in the future, have become important issues that need in-depth discussion and resolution between theoretical research and practical exploration. Only by clearly answering these questions can a clear path for the high-quality development of financial asset management companies in the new environment be provided, while also offering scientific foundations and practical guidance for related policy formulation and industry regulation. This not only concerns the long-term development of financial asset management companies but also has important implications for the sound operation of China's financial system.

2. Path Dependence of the Inherent Investment Models of the Five Major AMCs

Currently, financial asset management companies (AMCs) face significant development bottlenecks, with a large degree of policy-driven path dependence. The path dependence theory by economic historian Douglas C. North suggests that initial choices largely determine the subsequent development trajectory [12]. Since the establishment of financial asset management companies, they have always carried a policy-based function, and this initial positioning has profoundly influenced their subsequent evolution. Over the past two decades, this positioning has kept them confined within the regulatory framework and institutional design goals of their policy functions. This path dependence is still evident in their current business practices, and there is an urgent need to find breakthroughs through theoretical reflection and practical innovation.

From the original institutional design of the four major financial asset management companies in China, their initial positioning was that of policy-based financial institutions. According to the regulations of the *Financial Asset Management Company Regulations*, these companies' primary goal is to recover assets and minimize losses as much as possible, with profit maximization not being their top priority. This is fundamentally different from the objectives of commercial financial institutions. According to the "Measures for the Management of Bulk Asset Transfers of Non-Performing Assets of Financial Enterprises," each province is generally allowed to establish or authorize only one asset management company to handle non-performing assets, and large-scale non-performing assets can only be directed to these financial asset management companies for transfer. Additionally, the *Guiding Opinions from the General Office of the China Banking and Insurance Regulatory Commission on Encouraging* Financial *Asset Management Companies to Focus on Their Core Business and Actively Participate in the Reform and Risk Mitigation of Small and Medium-Sized Financial Institutions* (No. 62) clearly states that asset management companies should return to their origins, focus on their core business, clarify their role in the national economic and financial system, and play a counter-cyclical rescue function. These regulations reflect the policy-based objectives in the operations of financial asset management companies. However, regulatory documents also require financial asset management companies to adhere to marketization and rule of law principles in their operations, strengthen the acquisition, management, and disposal of non-performing assets of small and medium-sized financial institutions, and improve the efficiency and effectiveness of their disposal processes.

In the context of policy-driven path dependence, financial asset management companies have been endowed with market-oriented attributes, which has led to operational difficulties. The capital market has shown a clear negative response to this. Taking Cinda Asset Management (01359.HK), a relatively stable company, as an example, by the end of 2023, its total assets had approached 1.6 trillion RMB. However, since its listing on the Hong Kong Stock Exchange in 2013, Cinda's stock price has continuously declined, failing to achieve the expected growth. Its market capitalization has dropped from over 100 billion RMB at its peak to below 50 billion RMB, with a price-to-earnings ratio of only 11.69 times and a price-to-book ratio as low as 0.29 times. This valuation level is comparable to that of a mid-sized rural or urban commercial bank and is significantly lower than market expectations. A similar situation has occurred with Huarong Asset Management (now renamed Citic Financial Asset Management). The company reported a massive loss of up to 100 billion RMB in 2020, followed by a restructuring by Citic Group and a name change in 2024. The root cause of these issues lies in the ambiguous functional positioning of financial asset management companies. For market investors, regulatory changes, which require these companies to return to their policy-based functions and focus on non-performing asset disposal, financial risk mitigation, and serving the real economy, are seen as signals that the companies are gradually returning to their role as policy institutions. This adjustment may suggest that the companies no longer prioritize maximizing shareholder value or profits, and that in practice, they may experience situations where the aim is to maintain capital with minimal profits or even losses, with returns falling below private capital expectations, potentially harming shareholder value.

From the perspective of their current business models and development, China's five major financial asset management companies primarily engage in the acquisition of non-performing assets from banks, a business that falls under the traditional non-performing asset disposal sector. Although this business is formally conducted through market-oriented bidding, since bank asset transfers and acquisitions are strictly regulated, most market participants are unable to participate, and it essentially remains a policy-driven activity. These companies also engage in a certain amount of commercial business, such as asset management and disposal through debt restructuring, asset swaps, and additional investments. Some companies have expanded into multiple financial sectors through subsidiaries, including banking, securities, futures, public funds, trusts, leasing, and others. However, the diversification of these non-core businesses has led to the main business contributing only about 50% of key indicators such as asset scale, revenue, and profit, failing to bring about significant growth. This reflects the continued shrinkage and functional degradation of the policy-based core business of financial asset management companies.

In recent years, after returning to their core functions, AMCs still primarily focus on acquiring non-performing asset packages from commercial banks and disposing of them through retail, earning a profit from the price difference. However, their progress in developing core capabilities such as investment banking operations, cross-cycle management, and asset value enhancement remains slow [13]. Some scholars argue that national AMCs, local AMCs, and bank-affiliated AMCs all exhibit business homogenization. Due to the lack of differentiated, specialized financial service tools, there is a certain degree of vicious competition in the market. AMCs still primarily focus on traditional three methods (packaging, discounting, and litigation), quickly recovering funds, while the new three methods (restructuring, reorganization, and reconstruction), which requires higher technical input, longer cycles, and offers higher profits, accounts for a relatively low proportion [14]. The root cause of this phenomenon lies in the distortion of the "two rates" (cash recovery rate and cost rate) in policy-based acquisitions, which have been turned into economic benefit assessment targets for the preservation and appreciation of state-owned assets. According to the Ministry of Finance's *Notice on the Evaluation of Financial Enterprises' Performance*, financial asset management companies are required to distribute 30% of their annual net profits attributable to shareholders as dividends. The five major AMCs are among the central financial enterprises subject to evaluation. While Document No. 62 points out the need to improve the performance evaluation system and for asset management companies to establish internal evaluation systems that are conducive to resolving financial risks, the evaluation criteria still include business indicators such as new investments, self-disposal capabilities, disposal progress and effectiveness, and intermediary business income. These indicators should also comprehensively reflect the effectiveness of asset management companies in playing their unique role in mitigating financial risks. Once compensation mechanisms are linked to operational profits, AMCs are bound to lean toward expanding their asset scale to maximize profits, leading them to rely heavily on short-cycle, quick-turnover "three Ds" businesses. By frequently acquiring asset packages to increase total assets, AMCs not only accumulate systemic importance and external risks, but also, due to their "too big to fail" characteristic, force the government to intervene in case of a crisis [15]. Therefore, financial asset management companies have gradually deviated from their original policy-based function of focusing on bank non-performing asset disposal and have evolved into new sources of non-performing assets. This shift has led them to stray from their original policy-based functional positioning.

China's financial asset management companies' excessive pursuit of economic benefits is closely linked to the market-driven orientation and the regulatory policies and evaluation mechanisms. From an objective standpoint, regulatory evaluations act as a "guiding hand" for state-owned financial institutions, and in practice, they cause policy-based activities to give way to market-oriented goals in order to achieve better evaluation results. This phenomenon suggests that, when financial asset management companies return to their core functions, it is not enough to merely return to the past policy-based path, nor can they continue down the mistaken path of transformation. Instead, within the framework of national policy-based functional positioning, a new development path should be explored that aligns with the demands of the times, effectively balancing the conflict between policy and market-driven goals [16].

3. Policy-Based AMCs vs. Market-Oriented AMCs

As an important institutional arrangement for preventing and resolving financial risks, the common international practice is to dissolve financial asset management companies (AMCs) after a crisis and return them to their parent banks, or to carry out a complete commercialization transformation. Although China's four major AMCs initially had a ten-year lifespan in mind, they began to explore a market-oriented transformation and continue to operate to this day after the completion of their policy-based tasks. The reason for this is that non-performing assets have significant cyclical characteristics, which means that the risks associated with them will concentrate and repeatedly explode during certain periods, thus requiring China’s AMCs to continue to exist to take on long-term policy tasks. It also means that the imbalance between supply and demand in the non-performing asset market causes significant performance fluctuations, indirectly creating conditions for the market-oriented operation of AMCs.

In this process, the AMCs, which originally undertook policy-based tasks, were influenced by the concept of autonomous management and self-financing under a market economy, and began to choose a market-oriented transformation. This gradually blurred the basic development positioning of the AMCs, both from a regulatory and internal perspective. The intertwining and ambiguity of the "policy-based" and "market-oriented" identities led to a situation where, on one hand, the original policy-based business became increasingly difficult to maintain due to industry cyclical fluctuations and intensified market competition, and on the other hand, the market-oriented operations were often constrained by policy-based tasks, preventing the AMCs from maximizing their potential benefits. This contradiction is particularly evident in the listed AMCs, such as China Citic Financial Asset and Cinda Asset, where, as listed companies, they are required to focus on shareholder wealth maximization and stock price performance, but as state-owned enterprises, they also have to shoulder certain policy-related tasks. During economic upturns, this balance can be somewhat maintained, but once the economy slows down and asset quality deteriorates, the financial performance of AMCs, which are burdened by asset depreciation and capital pressures from earlier investments, does not align with the performance evaluation criteria that focus on profitability and operational growth [17]. This is the current operational challenge faced by most AMCs.

3.1. Clarification of the Policy-Based Financial Function of AMCs

Policy-based finance, as opposed to commercial finance represented by commercial banks, is an essential part of the financial system in developed countries. In the early stages of China's reform and opening-up, there were no specific financial institutions dedicated to policy-based tasks. In the late 1980s, scholars began advocating for the separation of the two [18], and it wasn't until 1994 with the establishment of policy-based banks such as the China Export-Import Bank that policy-based finance in China became a reality. Policy-based finance refers to a financial arrangement initiated or funded by the state, with the goal of not pursuing profit maximization, but rather achieving specific economic objectives through special financing means [19]. Policy-based finance was first implemented in the banking sector in China, benefiting from China's bank-dominated indirect financial system. Early AMCs, which were important components of the non-bank financial system stemming from the banking sector, also aligned with the concept of policy-based finance for the following reasons:

State Initiation and Funding: In the 1980s, following China's "credit reform" and the impact of the 1997 Asian financial crisis, the non-performing loan rate in domestic banks rose significantly. At that time, large commercial banks reported non-performing loan ratios of 25%, with estimates in the market reaching 35%-40% [20]. Systemic risk was close to breaking point. As China was in the critical period of applying for WTO membership, high non-performing loan ratios were incompatible with international regulatory standards, such as those in the Basel Accord, and had to be dealt with. Against this backdrop, in 1999, the Ministry of Finance invested 40 billion RMB to establish four national AMCs — Huarong (now China Citic Financial Asset), Great Wall Asset, Dongfang Asset, and Cinda Asset — to manage and dispose of the non-performing assets of the four major state-owned commercial banks, acquiring these assets at their book value. The Ministry of Finance allocated 10 billion RMB in registered capital to each AMC. In the face of the massive non-performing debts of the big four banks, this was obviously insufficient. The main funding for their operations came from more than 600 billion RMB in loans provided by the central bank through refinancing and more than 800 billion RMB in financial bonds issued to the China Development Bank and the four major banks. This clearly illustrates that the establishment of AMCs is different from that of ordinary market entities or commercial financial institutions and reflects the clear policy and administrative orientation of the state.

Non-Profit Objective: According to the *Financial Asset Management Company Regulations*, the primary operational objective of AMCs is to maximize asset preservation and minimize losses [21], which is fundamentally different from the pursuit of profit maximization in general market entities. In the early business model, during the first round of large-scale non-performing asset disposal by state-owned banks, AMCs acquired non-performing assets at their book value, without the autonomy to price the assets, making it impossible to reflect their true value [22]. This clearly did not align with the behavior of general market entities. Therefore, at that time, fulfilling the policy objectives was the primary goal for AMCs. It is important to clarify that the non-profit nature of AMCs does not contradict their use of market-oriented methods in operations. The pursuit of profit maximization is not their primary objective, but this does not mean that they must incur losses. AMCs can still better serve their policy-based functions.

Franchise and Specialized Operations: The four major AMCs were established with government authorization and, due to their rare financial licenses, naturally formed a franchise advantage in the primary non-performing asset sector. Despite market changes and industry developments, the positioning of non-performing asset disposal as their core business has not changed. Although regulatory agencies have expressed the functions and tasks of AMCs differently at different times, they have always guided AMCs to focus on policy-based finance. Therefore, AMCs differ significantly from commercial financial institutions in terms of their basic functional positioning. While they also operate under corporate management and market-oriented operations, they have specific business scopes, market barriers, and target clients.

3.2. Functional Alienation of AMCs in Practice

The term "alienation" originates from philosophy and refers to a process in which something evolves into a state that is distinct from its original form. Specifically, in the case of AMCs, the process of market-oriented transformation led to their deviation from their core responsibility of non-performing asset disposal, causing their policy-based functions to gradually dissipate [23]. This resulted in AMCs no longer meeting their intended role in China’s multi-level financial system, transforming them into new sources of financial risk and rescue targets. Looking back at the market-oriented transformation of AMCs, the simultaneous operation of policy-based objectives and market-oriented tasks within the same system inevitably led to rejection over time. From the 2018 Huarong Asset crisis to the current operational difficulties faced by Great Wall Asset and Dongfang Asset, these events show that the alienation of policy-based functions can cause great harm to both AMCs and the entire financial system. In general, the alienation of AMCs in market-oriented practices manifests in the following aspects:

Alienation of Functional Positioning: AMCs were initially established to offset the credit risk brought about by the profit-driven nature of commercial finance and to repair balance sheet deficiencies caused by such risks. However, under the conditions of a market economy, the pursuit of economic benefits by market participants led to confusion and misguidance in the transformation of AMCs. The goal of AMCs' market-oriented transformation should be to better serve their policy-based financial functions, not solely to pursue profit. Otherwise, their market-oriented attributes will gradually encroach upon and erode their policy-based space, and AMCs risk becoming commercial banks or investment banks disguised as policy-oriented financial institutions. The policy-based business of AMCs often involves public interests such as risk mitigation and improving efficiency. The social benefits and implicit contributions of AMCs' risk resolution and enterprise rescue during non-performing asset disposal are often difficult to quantify, while market-oriented performance metrics have clear advantages in evaluation. As a result, the policy-based evaluation indicators of AMCs are often overlooked, causing their policy-based function to weaken and gradually alienate.

Alienation of Core Business: In the process of market-oriented transformation, AMCs expanded their businesses into sectors such as banking, securities, insurance, and trusts through subsidiaries. This diversification led to a significant change in their business scope [24]. As a result, the proportion of revenue from traditional core businesses, such as non-performing asset disposal, sharply declined. In 2020, non-performing asset disposal accounted for only 23% of the total revenue of the four major AMCs. Some non-financial asset acquisition businesses played a role similar to "shadow banking" or "quasi-credit," which led to an increase in asset scale and operating indicators. However, under the influence of short-term development thinking, policy-based functions were gradually compromised in favor of profit considerations, and regulatory assessments became focused on economic efficiency. This created a vicious cycle, making AMCs more akin to financial risk amplifiers than financial risk mitigators [25].

Alienation of Organizational Structure: During their market-oriented transformation, AMCs participated in the disposal of financially troubled financial institutions through trusteeship, liquidation, and restructuring, gradually forming financial holding groups covering various financial licenses, including banking, insurance, securities, futures, and trusts. However, this financial holding model did not directly result in scale advantages or synergies. In practice, the subsidiaries under AMC holding companies performed inadequately in terms of resource and information sharing and business complementarity. This led to insufficient functional coordination, preventing the overall use of cross-licensing advantages to enhance the core ability to dispose of non-performing assets. Moreover, subsidiaries acquired through mergers and acquisitions face significant integration risks in terms of corporate culture, business philosophy, and economic interests. Some poorly managed subsidiaries have become overly reliant on the parent company for financial support, further "hijacking" the AMC and eroding the operating performance at the consolidated group level.

3.3. The "Repatriation" of Policy-Based Functions of AMCs

For a long time, both in theory and practice, the relationship between the "policy-based" and "market-oriented" functions of AMCs has not been clearly defined. By reviewing the functional positioning of AMCs during their policy-based period and the "detours" during their market-oriented transformation, it is clear that these functions are neither parallel nor oppositional but rather represent a relationship of purpose and means, service and being served [26]. In terms of AMC's goal orientation, the policy-based objective is primary, and market-oriented operations should serve as a means or tool to achieve these objectives. For instance, by listing, AMCs can raise low-cost funds, improve their capital structure, and enhance corporate governance, which also benefits their policy-based financial functions.

The cyclical nature of non-performing assets means that AMCs, as dedicated institutions for acquiring and disposing of non-performing assets, must exist long-term within China’s financial system. The alienation of their functions has shaken their political value as counter-cyclical financial rescue tools and poses risks to the stability and security of the Chinese financial system. How to achieve a rational return of AMCs’ functional attributes from "alienation" to "repatriation," from "is" to "ought," is an urgent issue that needs to be addressed. From the perspective of China’s regulatory system, how to utilize the policy-based financial function of AMCs without excessive administrative regulation, while also responding to the practical need for policy-based institutions to participate in market-oriented operations, is another important question that requires resolution.

4. Investment Expansion and Innovation of AMCs in the Changing Financial Landscape

In the context of major changes in the industry, policy, and regulatory environment of the financial sector, national AMCs, as special financial institutions, have reached a crossroads. Looking back, the four major AMCs have long been plagued by problems: Huarong Asset Management has been merged into CITIC Group; Dongfang Asset and Great Wall Asset have been weighed down by heavy historical burdens, almost collapsing under the pressure of internal non-performing assets and previous financial subsidiary investments; Cinda Asset, while relatively better, has seen its profits decline year after year in recent years, with its market value remaining persistently below book value; the newly established fifth national AMC, Galaxy Asset, has focused on new businesses such as “lightening” and “transformation,” but overall, it is still in its early stages, with a small scale. The challenge now is how to find a new path under the current circumstances, breaking through and innovating in non-performing asset investment, which has become an unavoidable issue for national AMCs at this stage.

4.1. A Market Full of Opportunities in Non-Performing Asset Investment

From the perspective of investment opportunities in non-performing assets, China's non-performing asset market still offers many opportunities. As China's economy continues to experience a downward cycle, the volume of non-performing assets across different sectors and types has been increasing steadily.

From the banking side, due to the sluggish real economy, continuous declines in housing prices, and the real estate sector entering a downturn, the quality of credit assets has continued to suffer, leading to a general rise in non-performing loan ratios. Among these, small and medium-sized financial institutions have been especially affected by factors such as poor asset quality and operational challenges, with non-performing asset issues particularly pronounced. At present, a large volume of non-performing assets has accumulated within China's banking system, urgently needing to be resolved. In the first quarter of 2024, the China Loan Transfer Center reported 65 non-performing loan transfer transactions, with a total value of 15.86 billion RMB and a transaction volume of 14.83 billion RMB, both higher than the same period in 2023. Given the current overall economic situation, traditional banking non-performing asset businesses still have considerable potential for growth in the foreseeable future.

From the enterprise side, many listed and unlisted companies face severe debt problems, as evidenced by the publicly traded bonds in the market. Between 2022 and 2023, a total of 410 bonds defaulted in China, involving 114 entities, with a total amount reaching 86.6 billion RMB. Among the enterprises drowning in debt, many are specialized and technologically advanced firms, which, despite facing business difficulties due to industry downturns, possess valuable core assets that could be restructured. The large number of such distressed enterprises provides opportunities for bankruptcy reorganizations, debt restructuring, and debt-to-equity swaps aimed at rescuing these companies. For example, the five major Asset Management Companies (AICs), all established in the second half of 2017 with registered capital ranging from 10 to 12 billion RMB, have focused on market-based debt-to-equity swaps as their main business. By the end of 2020, the total amount of market-based debt-to-equity swaps reached 1,005.4 billion RMB. During the same period, the four national AMCs and local AMCs also participated in enterprise debt restructuring. National policies have encouraged various financial and investment institutions to engage in enterprise debt resolution, and numerous policy documents, including *Guidelines for Market-Based Bank Debt-to-Equity Swaps, Opinions on Actively and Prudently Reducing Corporate Leverage*, and *Notice on Encouraging Relevant Institutions to Participate in Market-Based Debt-to-Equity Swaps*, have been released in support of this. It is evident that both from market demand and policy guidance, China's market for corporate debt non-performing asset investments is substantial.

From the government side, the debt resolution of local governments and their financing platforms also requires the involvement of non-performing asset investment institutions. According to data from the Ministry of Finance, by the end of 2023, the total statutory debt of local governments was 40.7 trillion RMB, with an additional 14.3 trillion RMB in hidden debt. While some local governments have clearly overborrowed, much of this debt still has the potential to be resolved. Since local borrowing is largely used for capital expenditures (including infrastructure construction), much of the debt is tied to valuable assets. These assets and the cash flow they generate form the basic conditions for future debt resolution, and non-performing asset investment institutions, especially state-owned ones, will be crucial for their resolution.

In addition to traditional debt-type assets, there are also many atypical alternative non-performing assets with investment value. For example, the value of stockpiled film and television copyrights that cannot be marketed due to issues such as censorship, problematic celebrities, or broken funding chains has exceeded 100 billion RMB. These assets, through re-editing and revaluation, still have opportunities to be marketed and their value restructured.

Thus, China’s non-performing asset market is vast, with a large volume and variety of assets, containing countless investment opportunities waiting to be discovered. From the supply side of the non-performing asset market, there is no shortage of directions for asset management companies to expand into.

4.2. The Dilemma of State-Owned Non-Performing Asset Investment Institutions

China’s state-owned non-performing asset investment institutions, particularly the four major AMCs, have undergone a transformation from being purely policy-based institutions to becoming commercialized entities. During this process, policies and regulatory requirements gradually evolved into a dual system with two types of positioning and two parallel regulatory mechanisms.

On one hand, the *Financial Asset Management Company Regulations* still apply, with the primary goal of maximizing asset preservation and minimizing losses. Regulatory agencies still assess national AMCs on their risk mitigation indicators. The newly released “Document *No. 62*” also requires AMCs to return to their roots, focus on their core business, and play a counter-cyclical rescue role. On the other hand, as state-owned financial institutions, AMCs are subject to the Ministry of Finance's *Financial Enterprise Performance Evaluation Measures,* which assess their profitability (including capital return rate, asset return rate, cost-to-income ratio, income-to-profit ratio, expense-to-profit ratio, and weighted average return on net assets) and operational growth (including capital preservation rate, profit growth rate, and economic profit rate). These two indicators are given a weight of 45% and 40%, respectively. While appropriate adjustments are made for higher concentrations of non-performing asset business, these adjustments have little impact on the overall evaluation, and the main focus remains on profitability and operational growth.

These two examples highlight the confusion caused by the dual positioning and goals of AMCs as both policy-oriented and market-oriented entities. The two regulatory logics are causing confusion in the business strategies of financial asset management companies. Under the guidance of these two evaluation systems, the business operations of financial asset management companies have gradually alienated. On one hand, the four major AMCs, seizing the opportunity to aid small and medium-sized financial institutions, have aggressively expanded and gradually formed financial holding groups, leading to significant increases in asset scale and revenue. On the other hand, some of their operations, such as exaggerating the non-performing attributes of certain assets and packaging them with complex transaction structures to engage in "quasi-loan" businesses with low-cost funds, have made them akin to shadow banking in China’s financial market. Meanwhile, traditional bank non-performing asset acquisition and disposal, which should be the core business, has, in some cases, become a "non-core business" in reality, with some provincial branches of national AMCs even exiting the primary non-performing asset market in their respective regions.

If it examines the contradictions in the regulatory logic in the current non-performing asset investment market, it can be found that state-owned financial asset management companies are caught in an awkward situation. For example, in the case of debt enterprise rescue operations, even with sufficient funds for rescue, the success of a company in overcoming its difficulties depends on the market environment, industry cycles, and economic conditions, which are often not resolved quickly. However, according to the regulatory evaluation criteria for AMCs, failure to achieve returns within a short period of time will directly affect their evaluation results. Guided by these criteria, state-owned financial asset management companies are less willing to invest in long-term, stable projects that require substantial funding, as such projects often align with the greatest demand for debt relief and require state-owned institutions' intervention and assistance.

4.3. The Path Forward for AMCs: Reconstructing Regulatory Logic

Currently, China’s non-performing asset market still offers a large number of investment opportunities. However, financial asset management companies are limited by their contradictory dual regulatory requirements. Whether dealing with policy-based risk mitigation projects or market-oriented profit projects, they are hindered by adverse evaluations from the other side, preventing smooth investments. The real limitation for financial asset management companies is not the non-performing asset market, but rather their contradictory identity. Over time, financial asset management companies will face an unfavorable situation where they cannot effectively meet policy goals or achieve long-term stable profits, thus failing to mitigate financial risks or rescue entities at various levels, and also failing to create value for shareholders.

To change this situation, the regulatory framework for the AMC industry should be restructured from the top down. If the goal is to achieve both policy-based and market-based objectives, the management of national AMCs should be unified, and differentiated responsibilities should be assigned. Specifically, some AMCs could be transformed into purely policy-based institutions, while others continue along their commercialization path. Purely policy-based AMCs would not focus on profitability as an evaluation target but would return to their original policy-driven mission of risk mitigation. Their core business would include the acquisition and disposal of bank non-performing assets, local government debt resolution, and debt enterprise rescue. Given that these AMCs would be dedicated to policy tasks, they would inevitably face challenges such as low asset recovery, so their evaluation should focus on achieving political tasks, not merely reducing non-performing asset losses.

From a policy-making perspective, the original intention behind the market-oriented transformation of the four major AMCs was to enhance their ability to handle non-performing assets, allowing them to serve risk mitigation through market-oriented means, rather than turning them into purely commercial institutions. In other words, market orientation is a tool, and policy orientation remains the goal. The market-oriented transformation should ultimately serve the policy objectives. Therefore, restructuring the regulatory logic of financial asset management companies to promote their return to their core business is essential for achieving this goal.

On the other hand, since some financial asset management companies have already been listed and become public companies, they have a market responsibility to their shareholders, especially minority shareholders. In this case, profitability is a key factor for these institutions. Thus, some of these AMCs could be transformed into commercial institutions, with the state, as a shareholder, only evaluating their performance and profitability, without requiring them to undertake policy-related tasks. This would not only fulfill responsibilities to investors and the market but would also avoid turning these financial asset management companies into "bad debts" for investors, providing a profitable path and goal for these institutions within a unified management model.

It should be noted that the division of roles applies to the nature of the institution, not its business type. If a risk mitigation project can generate profit, a policy-based institution can still participate and benefit from it. Likewise, if policy-based business can generate profit, commercial institutions can participate. This differentiation does not block business development but helps clarify the roles and directions of each institution, contributing to a healthy and smooth market order. Under this arrangement, financial asset management companies will have a clear identity and operational strategy, while maintaining flexibility and autonomy in their business layout, and will be able to develop businesses based on their goals, market conditions, and capabilities.

Thus, by differentiating the regulatory positioning of financial asset management companies, managing them as a whole, and clarifying their responsibilities, it can create a new path to address the current challenges faced by these institutions.

5. Conclusion

The market-oriented nature of AMCs represents the ultimate trajectory and destination for the open development of the non-performing asset (NPA) market, while policy-oriented AMCs were originally an emergency measure implemented by the state to rescue market entities in the nascent stages of the NPA market. Over the past two decades of development in China’s NPA market, the identity of financial asset management companies has shifted from being purely policy-driven entities to their current hybrid state, combining elements of policy and market orientation. Such an ambiguous positioning in the market makes it difficult for AMCs to fully perform their intended functions. Therefore, assigning distinct roles and identities to state-owned financial asset management companies within the market, enabling them to serve different purposes in the NPA sector, is a prerequisite for the healthy and sustainable development of the NPA market.

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