

The Journal of Financial Crises

Volume 3 | Issue 2

2021

China: 1999 Asset Management Corporations

Lily S. Engbith
Yale University

Follow this and additional works at: <https://elischolar.library.yale.edu/journal-of-financial-crises>



Part of the [Economic History Commons](#), [Finance and Financial Management Commons](#), [Macroeconomics Commons](#), [Policy Design, Analysis, and Evaluation Commons](#), [Policy History, Theory, and Methods Commons](#), and the [Public Administration Commons](#)

Recommended Citation

Engbith, Lily S. (2021) "China: 1999 Asset Management Corporations," *The Journal of Financial Crises*: Vol. 3 : Iss. 2, 485-496.

Available at: <https://elischolar.library.yale.edu/journal-of-financial-crises/vol3/iss2/23>

This Case Study is brought to you for free and open access by the Journal of Financial Crises and EliScholar – A Digital Platform for Scholarly Publishing at Yale. For more information, please contact journalfinancialcrises@yale.edu.

China: 1999 Asset Management Corporations¹

*Lily S. Engbith*²

Yale Program on Financial Stability Case Study
June 23, 2021

Abstract

Chinese financial authorities began to liberalize their economy in the 1970s, though it would take two more decades to realize a solution to the massive non-performing loan (NPL) problem faced by state-owned commercial banks (SOCBs). In order to remove and dispose of bad assets left over from the policy-lending era of the former command economy, the State Council created four public asset management corporations (AMCs) between April and October of 1999. The AMCs, under the administration of the Ministry of Finance, were responsible for the acquisition, management, and disposal of NPLs from their assigned state-owned commercial bank. In addition to maximizing returns on the recovery of assets offloaded by the SOCBs, the AMCs were mandated to assist in the restructuring of state-owned enterprises (SOEs) by facilitating debt-to-equity swap agreements. The government provided funding for NPL purchases in the form of an initial equity capital injection of RMB 40 billion (provided by the Ministry of Finance [MoF] and split equally among the four AMCs), credit from the People's Bank of China (PBoC), and special AMC bonds held by the big four state-owned commercial banks. In total, RMB 1.4 trillion (1 USD = RMB 8.3 in 1999) in NPLs were acquired by the four AMCs over the course of 1999 and 2000. After having transferred approximately RMB 136.3 billion (USD 16.9 billion) to the MoF and PBoC, the AMCs ceased NPL operations by the end of December 2006. They have since been restructured to operate as nonbank financial institutions.

Keywords: China, asset management corporations, asset purchase programs

¹ This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering broad-based asset management company programs.

Cases are available from the *Journal of Financial Crises* at <https://elischolar.library.yale.edu/journal-of-financial-crises/>.

² Research Associate, YPFS, Yale School of Management.

China: 1999 Asset Management Corporations

At a Glance

While the Chinese government began to liberalize its command economy in the 1970s, it was not until the mid-1990s that it enacted an ambitious program of fiscal, monetary, and regulatory reforms to restructure its financial system. This involved, among other interventions, recapitalizing the state-owned commercial banks, opening up the command economy to foreign competition, and bolstering financial regulation and supervision (García-Herrero et al. 2006). The Ministry of Finance (MoF) was particularly concerned with the removal of non-performing loans (NPLs) from the balance sheets of state-owned commercial banks whose portfolios were estimated to account for up to 65% of total loans outstanding by the late 1990s (Fung and Ma 2002).

Like their counterparts in many Asian countries at the time, Chinese government officials decided to create “resolution agencies” for the express purpose of acquiring and disposing of bad assets (Fung and Ma 2002). These four asset management corporations (AMCs), formally established by the State Council between April and October of 1999, were mandated to acquire and resolve NPLs left over from the policy lending days of the centrally planned economy (Bonin and Huang; Fung et al. 2011; Fung and Ma 2002). The entities were structured as individual state-owned enterprises (SOEs), wholly owned and operated by the

Summary of Key Terms	
Purpose:	To purchase non-performing loans from four state-owned commercial banks and dispose of them over a period of 10 years (Fung and Ma 2002)
Launch Dates	Announcement: April 1999 First transfer: September 1999 by Cinda Asset Management (Bonin and Huang 2000)
Wind-down Dates	December 2006
Size and Type of NPL Problem	40% of total banking system loans (Fung and Ma 2002) Residual NPLs of state-owned commercial banks left over from the command economy
Program Size	Not specified at outset
Eligible Institutions	Big four state-owned commercial banks Open-bank only
Usage	RMB 1.4 trillion (USD 169 billion) by four institutions between 1999 and 2000 (Fung and Ma 2002)
Outcomes	RMB 136.3 billion (USD 16.9 billion) in funds generated by disposal of assets as of March 2005 (García-Herrero et al. 2006)
Ownership Structure	Government-owned
Notable Features	AMCs also mandated by the government to manage debt-for-equity conversion agreements for state-owned enterprises (Fung and Ma 2002); At some unspecified point, the AMC-partner bank model evolved into an auction model (García-Herrero et al. 2006)

Ministry of Finance (MoF) but allowed to intervene in the market on behalf of the government (Fung and Ma 2002). Secondarily, the AMCs were responsible for the restructuring of some large-debtor SOEs through debt-to-equity conversion agreements (Bonin and Huang 2000; Fung and Ma 2000).³

Each AMC was initially paired with one of the four largest state-owned commercial banks, a divide-and-conquer strategy that had been employed by Swedish authorities to manage the decentralized NPL problem (García-Herrero et al. 2006; Fung and Ma 2002). Funding was provided in a variety of forms, including an RMB 40 billion⁴ equity capital injection provided by the MoF and split equally among the four AMCs, credit from the People's Bank of China (PBoC), and non-tradeable AMC bonds issued to the big four partner banks in exchange for transferred assets. Although the State Council legally allowed the AMCs to engage in commercial borrowing to fund its purchases, there had been no documentation of such activities as of 2001 (Fung and Ma 2002).

The AMCs were mandated to maximize NPL recovery over a period of ten years (Bonin and Huang 2000). During the first restructuring wave, each AMC acquired NPLs from its partner SOCB at face value for a total amount equivalent to 8% of GDP, issuing a 10-year bond with an annual 2.25% coupon for 83% of that amount and paying the remaining 17% in cash. At some unspecified point between the first and second waves of NPL transfers, the government decided to switch from the partner-bank model to a more traditional auction model which allowed AMCs to place bids for the remaining assets (García-Herrero et al. 2006). Cinda Asset Management, which had far outperformed its counterparts in terms of maximizing asset recovery, won the bid by promising a 30% recovery rate (Fung and Ma 2002; García-Herrero et al. 2006). As of 2002, Cinda accounted for nearly 40% of all cash recovery by the four AMCs (Fung and Ma 2002).

At some point over the course of AMC operations, Chinese authorities decided that the end of 2006 would be the deadline for resolving NPLs still held by the AMCs. RMB 136.3 billion (USD 16.9 billion) in cash funds were generated by the disposal of assets as of March 2005 (García-Herrero et al. 2006).

Summary Evaluation

While there has been little evaluation of the success of the AMCs in isolation, secondary sources have argued that Chinese authorities took major steps toward resolving the national NPL problem by establishing the AMC regime (Fung and Ma 2002; García-Herrero et al. 2006). Fung et al. (2011) write that the establishment of the AMCs was “a pre-emptive measure to restructure and strengthen the Chinese banking system.” However, Fung and Ma

³ For further analysis and commentary on the debt-to-equity conversions, please refer to Fung and Ma 2002.

⁴ 1 USD = RMB 8.3 in 1999 (International Monetary Fund, International Financial Statistics).

(2002) emphasized that the AMCs were “burdened with multiple tasks of quick asset disposition and medium-term corporate restructuring,” the latter of which posed a substantial conflict of interest to the official mandate of maximizing NPL recovery. Bonin and Huang, writing in 2000, also foresaw problems regarding the state-owned structure of the AMCs and noted the logistical issues with staffing such specialized institutions with transfers from the four state-owned commercial banks and other government agencies. Additionally, the authors suggest that a moral hazard problem might arise from the one-to-one relationship between AMCs and partner banks, one that could “[foster] collusive behavior and [inhibit] competition” (Bonin and Huang 2000).

1999 Asset Management Corporations: China Context	
GDP (SAAR, Nominal GDP in LCU converted to USD)	\$1.0 trillion in 1998 \$1.1 trillion in 1999
GDP per capita (SAAR, Nominal GDP in LCU converted to USD)	\$829 in 1998 \$873 in 1999
Sovereign credit rating (5-year senior debt)	Data for 1998: Moody's: Data unavailable S&P: BBB+ Fitch: Data unavailable Data for 1999: Moody's: Data unavailable S&P: BBB Fitch: Data unavailable
Size of banking system	\$1.0 trillion in 1998 \$1.2 trillion in 1999
Size of banking system as a percentage of GDP	101.4% in 1998 110.2% in 1999
Size of banking system as a percentage of financial system	Data not available for 1998 Data not available for 1999
5-bank concentration of banking system	49.6% in 1998 47.1% in 1999
Foreign involvement in banking system	Data not available for 1998 Data not available for 1999
Government ownership of banking system	Data not available for 1998 Data not available for 1999
Existence of deposit insurance	No in 1998 No in 1999
<i>Sources: Bloomberg; World Bank Global Financial Development Database; World Bank Deposit Insurance Dataset</i>	

Key Design Decisions

1. Part of a Package: The transition from a command economy to a competitive banking system necessitated, among other measures, the restructuring of state-owned commercial banks through NPL resolution and public capital injections.

As part of this nationwide campaign to liberalize the command economy, Chinese authorities established four operationally similar asset management corporations (AMCs) to remove non-performing loans (NPLs) from state-owned commercial banks (SOCBs) (García-Herrero 2006; Fung and Ma 2002).

Officials launched the AMCs following a series of capital injections to the SOCBs, which began in 1998 with an RMB injection equivalent to USD 33 billion. This was followed in December 2003 by a targeted injection of USD 22.5 billion in the two “best-performing” SOCBs, China Construction Bank and the Bank of China (García-Herrero 2006). The third and final restructuring wave began in April 2005 with the injection of USD 15 billion into the Industrial Commercial Bank. All told, the Chinese government injected an estimated 20-24% of 2004 GDP into the banking system (García-Herrero 2006, 313).

2. Legal Authority: An executive order issued by the State Council in 2000 provided the principal legal basis for the establishment of the AMCs.

The executive order was issued a year after the actual setup of the four AMCs and did not include any explicit operational terms or details (Fung et al. 2011).

3. Special Powers: It does not seem that the Chinese authorities delegated special powers or authority to the AMCs.

Although the AMCs were mandated to conduct other operations aside from NPL management and disposal, it does not appear from sources consulted that they were given special powers for debt collection or recovery from debtors.

4. Mandate: The four AMCs were officially mandated to remove NPLs from state-owned commercial banks’ balance sheets, manage them prior to disposal, and maximize asset recovery over a period of ten years, while also helping to restructure large state-owned enterprises.

Cinda Asset Management Corporation, by far the most successful of the four AMCs in terms of cash recovery, was mandated to collect what it could from the borrowers; otherwise, it would repackage the loans for discounted sale on the secondary market (Fung and Ma 2002; Bonin and Huang 2000).

In addition to NPL purchase and resolution, the AMCs were responsible for managing debt-to-equity swap conversion agreements to support approximately 500 “large and heavily-indebted” state-owned enterprises (SOEs) (Fung et al. 2011; Fung and Ma 2002). According

to Fung et al. (2011), the government involved the AMCs in this restructuring effort in order to achieve SOE profitability within three years.

Apart from its mandated responsibilities, the AMCs were allowed to involve themselves in certain commercial activities. Such operations included the brokering of securities in order to facilitate the sales of equity holdings through stock listings. The AMCs thus intervened in the markets on behalf of the government, competing directly with the private sector and potentially raising a conflict of interest between policy mandates and commercial incentives (Fung and Ma 2002).

5. Ownership Structure: The four AMCs were solely owned by the Ministry of Finance.

The four AMCs were officially structured as SOEs, “state-owned non-bank financial institutions set up by the State Council,” until the Ministry of Finance was able to “propose solutions to final AMC loss” (Fung and Ma 2002).

6. Governance Structure: Though legally independent, the four AMCs were overseen by three government agencies, all of which answered to the State Council of the People’s Republic of China.

The three institutions interacted with the AMCs as follows:

- The Ministry of Finance (MoF) controlled the chairmanship for each of the AMCs’ boards of directors.
- The People’s Bank of China (PBoC) issued licenses defining the AMCs’ business scope and supervised the corresponding state-owned commercial banks.
- The China Securities Regulatory Commission (CSRC) supplied securities-related business permits and regulated the AMCs’ business operations (Fung and Ma 2002).

In order to carry out its debt-for-equity swap operations and resolve legal or logistical disputes, the AMCs would occasionally have to interface with other public institutions, such as the State Economic and Trade Commission, the Ministry of Foreign Trade and Economic Cooperation, and state and local governments (Fung and Ma 2002).

While the four largest state-owned commercial banks had no “formal” or “direct” equity stake in their partner AMCs, the informal relationship was not clear-cut (Fung and Ma 2002). The AMCs were staffed by former bank employees, while the president of each bank also served as the designated party chief of the corresponding AMC (Fung and Ma 2002).

Beginning in April 2003, the newly established China Bank Regulatory Commission (CBRC) became the main supervisory and regulatory authority responsible for overseeing the four AMCs. However, the AMCs were still required to report on a monthly basis to the MoF and PBoC and undergo onsite inspections by central bank officials (Fung et al. 2011).

- 7. Size: The government intended to equip the AMCs to deal with approximately RMB 1 trillion in NPLs, which amounted to slightly less than half of the estimated NPLs held by all Chinese banks.**

Ultimately, NPL transfers to the AMCs totaled approximately 13.5% of GDP by March 2005 (García-Herrero 2006).

- 8. Funding Source: It seems that the purchases of non-performing loans from state-owned commercial banks were funded exclusively by the Chinese government.**

The State Council allowed the AMCs to be financed by four sources: MoF equity, borrowed funds from the PBoC, AMC-specific bonds, and commercial borrowing from other financial institutions (Fung and Ma 2002).⁵ There are no official documents describing the sources in detail. Fung and Ma (2002) provide estimates based on limited public information.

The MoF initially provided an equity capital injection of RMB 10 billion to each AMC; because the transactions do not appear in state budget documents, it remains unclear how this funding was raised. While some portion of the investment probably comprised in-kind contributions (such as operational equipment), Fung and Ma (2002) treat the equity as cash in their analysis. The authors estimate that the RMB 40 billion accounts for about 3% of total funding to the AMCs.

It is likely that a substantial amount of funding for the AMCs (about 14%, or RMB 192 billion) was provided by the PBoC in the form of cash lending; however, only one AMC, Huarong Asset Management Company, disclosed funding from the PBoC on its balance sheet. According to Fung and Ma (2002), the PBoC funding did not “seem to have the expected monetary consequences,” in that China’s overall reserves remained stable and average growth only amounted to 8% per annum at the time.⁶ The authors (2002) speculate that some “offsetting movements,” namely the 65% decline (RMB 340 billion) in PBoC claims on the four SOCBs in 2000, contributed to the decrease in the banks’ liabilities. The SOCBs may have used their free reserves resulting from the NPL transfers to pay off their PBoC liabilities, or the central bank itself could have sterilized its lending to the AMCs by recalling its previous loans to the SOCBs. It is also possible that the PBoC financing might have been presented in the form of “liability transfers,” which would have involved the AMCs paying for their NPL purchases by assuming the SOCBs’ liabilities to the PBoC (Fung and Ma 2002).

Most of the funding—83% of policy transfers, or RMB 1.168 trillion—was financed by the issuance of non-tradable AMC bonds to the big four state-owned commercial banks. The “general belief” in Chinese financial markets was that the government would not let the

⁵ There was no evidence that the AMCs borrowed from private-sector sources as of 2001. Assuming there was no outside funding, Fung and Ma estimate that the partner banks swapped RMB 1.4 trillion in NPLs for a total of RMB 1.168 trillion in new AMC bonds and RMB 232 billion in cash (from the MoF and PBoC) (2002, 4). For a more detailed (but still speculative) breakdown of funding sources, please refer to Fung and Ma 2002.

⁶ For a more detailed explanation of the monetary implications of PBoC financing, please refer to Fung and Ma, 2002.

AMCs default on their bonds; “the Chinese AMCs [were thus] viewed as government-sponsored agencies” (Fung and Ma 2002). However, the government asserted a policy of “constructive ambiguity,” encouraging speculation about which institution (e.g., the MoF, the PBoC, or state-owned commercial banks) would bear the risk of default (Fung and Ma 2002). Without an implicit state guarantee, the AMC bonds would probably not have achieved a better risk rating than their underlying NPLs (Fung and Ma 2002).

The Chinese government set an interest rate of 2.25% on both AMC bonds and PBoC credit to the AMCs. This rate was based on the official one-year bank deposit rate in 2001. Using Fung and Ma’s (2002) estimates (MoF equity amounting to RMB 40 billion combined with the PBoC policy purchase of RMB 1.4 trillion), the four AMCs collectively borrowed RMB 1.36 trillion and thus owed over RMB 30 billion in annual interest.

9. Eligible Institutions: Initially, four public AMCs were matched with the four largest state-owned commercial banks.

The partner AMC-bank pairings were designated as follows:

- Orient Asset Management – Bank of China
- Great Wall Asset Management – Agricultural Bank of China
- Cinda Asset Management – China Construction Bank⁷
- Huarong Asset Management – Industrial and Construction Bank of China (Fung and Ma 2002)

According to García-Herrero et al. (2006), separation of NPL recovery operations between the four banks was seen to have had two advantages. First, it would be easier to divide and conquer the overwhelmingly diffuse client base and small loan amounts. Second, it seemed advantageous to assign specific AMCs their partner banks based on specialization (e.g., Great Wall would deal with NPLs from the agriculture sector).

At some unspecified point between the first and second NPL transfer, the AMC/partner-bank model evolved into a more traditional auction model. This allowed AMCs to place bids for the remaining assets (García-Herrero et al. 2006). Cinda Asset Management, which had far outperformed its counterparts in terms of maximizing asset recovery, won the bid from the four SOCBs by promising 30% asset recovery (Fung and Ma 2002; García-Herrero et al. 2006).

10. Eligible Assets: Eligible assets were restricted to NPLs generated by policy lending prior to 1996.

Chinese authorities faced a “daunting” NPL problem in the 1990s, mostly due to the significant amounts of policy loans left over from the centrally planned economy (Fung and

⁷ Cinda also differed slightly in that it ultimately acquired NPLs from the China Development Bank, one of China’s three policy banks (Fung and Ma 2002, 1).

Ma 2002). In addition, weak SOE performance and unregulated credit-risk controls on state-owned commercial banks contributed to the proliferation of bad loans (Fung and Ma 2002).

These “policy-based” transfers were also explicitly authorized and financed by the government (Fung and Ma 2002). In order to avoid issues of moral hazard, the government took responsibility for bank losses resulting from policy lending that occurred only before 1996. Officials declared an end to policy-driven NPL transfers in 2001 (Fung and Ma 2002).

11. Acquisition (Mechanics): The AMCs would remove NPLs from the state-owned commercial banks in exchange for government cash, credit, and AMC bonds.

Between 1999 and 2000, RMB 1.4 trillion in NPLs were transferred at face value from the state-owned commercial banks to four partner AMCs in exchange for government cash, credit, and AMC bonds. These transfers accounted for over 20% of the big four banks’ combined loan portfolios and amounted to about 18% of the country’s GDP in 1998. However, the scope of the NPL transfers may have been much greater than what was revealed at the time (Fung and Ma 2002).⁸

12. Acquisition (Pricing): The first wave of transfers of NPLs from state-owned commercial banks to the AMCs were conducted uniformly at book value; subsequent purchases used an auction-based model.

The second wave of transfers employed an auction-based model to award NPLs to the highest-bidding AMC. Cinda Asset Management, which promised 30% recovery and had previously outperformed the other AMCs, won the auction (García-Herrero et al. 2006, 315; Fung and Ma 2002, 12).

13. Disposal/Recovery: The AMCs were expected to collect what they could on the sale of assets by repackaging the loans and selling them at a discount on the secondary markets.

The AMCs claimed an average NPL resolution rate of 49.4% by March 2005 (García-Herrero 2006).

If the AMCs were unable to dispose of all transferred NPLs by the specified end date of 2006, the MoF would either take over the nominal equity or directly write off the remaining bad debt (Bonin and Huang 2000). As of March 2005, the AMCs had collectively recovered RMB 136.3 billion (USD 16.9 billion) in cash by the disposal of assets (García-Herrero et al. 2006).

⁸ For further analysis and commentary regarding the scope of uncertainties surrounding the NPL problem, please refer to Fung and Ma 2002.

14. Timeframe: Although each AMC was set up to operate for a period of ten years, the government later set the end of 2006 as the deadline for the resolution of NPLs .

Chinese officials announced upon establishment that the AMCs would operate for ten years; however, this provision was never explicitly stated in the State Council executive order (Fung et al. 2011). This timeframe was decided upon such that sunset provisions could be included from the outset (Bonin and Huang 2000).

Later, the government set the end of 2006 as the deadline for the resolution of all NPLs held by the four AMCs (García-Herrero et al. 2006).

References and Key Program Documents

Key Academic Papers

(García-Herrero et al. 2006) García-Herrero, Alicia, Sergio Gavilá, and Daniel Santabárbara. 2006. "China's Banking Reform: An Assessment of its Evolution and Possible Impact." *CEifo Economic Studies* 52, no. 2: 304-363.

Academic paper analyzing the various economic reforms undertaken by the Chinese government in the 1980s and 1990s.

<https://ypfs.som.yale.edu/library/chinas-banking-reform-assessment-its-evolution-and-possible-impact>.

Reports

(Bonin and Huang 2000) Bonin, John and Yiping Huang. 2000. "Dealing with the Bad Loans of the Chinese Banks." APEC Study Center, July 2000.

Discussion paper comparing the experiences of Eastern European asset management programs with those in China.

<https://ypfs.som.yale.edu/library/dealing-bad-loans-chinese-banks>.

(Fung and Ma 2002) Fung, Ben S.C. and Guonan Ma. 2002. "China's asset management corporations." Bank for International Settlements, August 2002.

BIS working paper describing the establishment and operations of the four AMCs in 1999.

<https://ypfs.som.yale.edu/library/chinas-asset-management-corporations>.

(Fung et al. 2011) Fung, Ben S.C., Jason George, Stefan Hohl, and Guonan Ma. 2011. "Public asset management companies in East Asia – Case studies." Bank for International Settlements, October 2011.

Comparative BIS report that analyzes updated data and operational details regarding China's AMCs.

<https://ypfs.som.yale.edu/library/public-asset-management-companies-east-asia-case-studies>.

Copyright 2021 © Yale University. All rights reserved. To order copies of this material or to receive permission to reprint any or all of this document, please contact the Yale Program on Financial Stability at ypfs@yale.edu.