

The Analysis of Current Chinese Non-performing Assets and Lessons and Insights Learned from Experiences of Foreign Banks' Non-performing Assets

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Abstract: In China's banking industry, the problem of non-performing assets has a long history and a large scale. It has become a major obstacle to the development of our national economy. If the problem is not resolved, it will become more and more severe and may even lead to a financial crisis. Thus, learning from foreign experience to solve the NA of Chinese commercial banks as soon as possible is crucial to fundamentally solving financial risks. This paper analyze the current situation of NA in Chinese banks caused by national industrial policy adjustment, use of monetary funds and severe flaws in the money-operating banks' management systems. From the successful experience of foreign banks in resolving NA, Chinese banks can diversify and utilize multiple disposal methods, with the support of government, in order to overcome the challenges of NA.

Keywords: financial risks, banks non-performing assets, international comparison, asset preservation

1. Introduction

NA not only reduces the liquidity, security, profitability and risk tolerance of banks, but also wastes and idles a part of social and economic resources, reducing the overall efficiency of the economy. The majority of NA in Chinese commercial banks are non-performing loans. Despite China's continuous economic growth, the size of commercial banks' deposits and loans has been growing. The issue of NA has also come to the fore. Various factors contribute to their development, including internal management system elements and the use of monetary funds. The external economic environment also influences the precipitation and stagnation of monetary funds.

However, more research is needed on the current situation of NA in China, especially on the difficulties currently encountered, policy needs, and bank management. This paper analyzes the current Chinese NA and examines how foreign experiences can help us address NA more effectively. In addition, the literature review and case studies are used to provide recommendations for banks in China to manage NA better.

2. Current Situation and Causes of China's NA

According to the Five-Level Loan Classification Guidelines issued by China's banking and insurance regulators, loans can be classified into five categories: normal, interest, secondary, doubt, and loss. The latter three categories can collectively be called non-performing loans [1]. In the past five years, the amount of non-performing loans and the non-performing loan ratio of commercial banks in China have risen. The amount of non-performing loans rose from RMB 6,591.4 billion in 2017 to RMB 1,125.96 billion in 2021, an increase of 70.82%, or an average annual increase of about 15% [2]. In terms of NPL ratio data, the NPL ratio was 1.74% in 2017, while this ratio grew to 2.36% by 2021, an increase of 35.63%, which is still a high increase. Comparing the growth rate of the NPL amount and NPL ratio, it is easy to find that the growth rate of the NPL ratio is much faster than the NPL amount, which indicates that in the five years from 2017 to 2021, although the NPL amount and NPL ratio are increasing, the overall loan size is also growing at a faster rate, which is why the NPL amount and NPL ratio have not achieved the same growth rate.

There is still a severe problem of non-performing assets in China's commercial banks, particularly in terms of the amount of non-performing loans and non-performing loan ratios.

The main reasons for banks' NA include moral hazard and adverse selection brought on by objective knowledge asymmetry, as well as institutional changes, credit connections, and the system of property rights.

The economic system, the way property rights are organised, the way goods are distributed, the size of the market, the pace of development, the state of the environment, the state of the world economy, technical advancements, and changes to the financial system are examples of external causes.

National industrial policy adjustment is a significant cause of phased and periodic NA. National industrial policy differs between historical periods. National industrial policies are executed using a combination of economic and administrative policies, such as capital tilts and price changes. With each adjustment of industrial policy, several firms that do not comply with the national industrial policy shut down, merged, or transferred, which is a significant factor in the development of NA in Chinese banks. Nowadays, policy-based loans account for a significant part of NA[3].

Internal factors include the division of labor in the financial industry, the degree of centralisation of monopolies, the relationship between banks and businesses, the commodification of capital, and the degree of interest rate marketisation. The two most fundamental causes are listed below.

First, in the process of deepening reform and extending growth, firms utilising monetary funds have chosen an over-indebted business strategy, which has resulted in the frequent occurrence of bank loans, "triangular debts", and "serial debts" and has had a significant impact on the quality of banks' credit assets.

Second, the severe flaws in the money-operating banks' management systems are directly responsible for the growth of NA. Due to the information asymmetry between the owner of the funds (banks) and the users of the funds (enterprises), particularly the severe distortion of financial information and the loosening of financial constraints, it is difficult for banks to make a high-quality assessment of the projects prior to granting loans, and loan management becomes a formality, thereby increasing the difficulty of disposing of non-performing assets [4]. Insufficient construction of the disposal team, such as the arrangement of near-retirement workers whose capacity to dispose of non-performing assets is constrained for energy reasons [5]. Furthermore, risk awareness in loan approval is weak, subjective, and arbitrary, and some loans are issued in violation of the law, with loans issued and recovered without individual responsibility and no supervision following the issue of loans to the bank in a passive risk acceptance role.

As a result, the development of NA in Chinese banks and the exacerbation of the problem are caused by internal factors about the bank management and primary body of utilising monetary funds, as well as external economic factors contributing to the stagnation and sinking of the monetary funds.

3. Successful Experience of Foreign Banks in Resolving NA

In the mid-1980s, US savings and loan institutions suffered a credit crisis as the impact of the interest rate turmoil from 1977 to 1980 led to a shift in credit risk between 1983 and 1986. By 1988, over 1,400 banks were in trouble, with over 200 failings. To address this problem, the US government established the Resolution Trust Corporation (RTC) with a budget of US \$50 billion and authorized the takeover of all insolvent savings and loans. The RTC used buyouts that assumed liability (P&A style buyouts) and deposit payments or transfers of insured deposits to deal with non-performing assets. In its six years of operation, the RTC got rid of 747 savings and loans associations with a book value of US \$403 billion in assets processed, or 98% of the total assets transferred. The cumulative net loss on assets was US \$87.9 billion, and most Savings and Loan Clubs returned to business as usual [6]. The RTC's success became a model for many countries worldwide to follow. At the same time, the US also created another model for dealing with non-performing loans, i.e., transferring non-performing assets to independent non-performing banks for realization, which proved effective. The economic boom in the 1990s in the US was built on the successes of this time.

Poland exemplifies how several Eastern European nations undergoing transformation, such as the Czech Republic, have also had successful experiences with NA. Poland has dealt with non-performing assets by establishing a "sinking asset management unit" under the direction of the central bank, with the participation of other creditors and foreign investors [7]. For large companies that are hard to restructure, the "restructuring technique" moves non-performing credit assets to the government's "liquidation" department. Financially unstable state-owned enterprises are restructured on the capital market through debt-equity swaps, loan rescheduling, etc [8]. In addition, the government has created an internal "liquidation" agency. In addition, Poland has established an internal "sinking asset management department" to categorize and deal with non-performing loans that do not impair the bank's operations' stability and avoid the societal discontent produced by widespread bankruptcy and liquidation. These methods have solved the problem of bad bank loans, made banks more financially stable, and kept the public's trust in the banking sector.

4. Lessons and Insights Learned from Experiences of Foreign Banks' NA

The following lessons and insights can be drawn based on the above comparison of foreign measures to deal with banks' NA.

4.1. Diversify and Utilize Multiple Disposal Methods

Firstly, it is conceivable to dispose of NA by separating good from bad assets and selling them at a discount. To solve the problem of NA on a large scale, banks need to set up an agency to sell off non-performing debts and separate the banks' good and bad assets. This way, the good assets can be run responsibly, and the bad assets can be sold at a discount to get the money back. The significant buildup of NA in China and the escalation of the crisis need the quick formation of this organization. In addition, banks can also conduct extensive classification management and create disposal methods. Using the Internet and current financial technologies, banks should develop a system and process for getting rid of NA based on the type and risk of NA. For instance, banks should build the disposal system and process for NA based on internet credit, including asset securitization, debt-to-equity exchange, trusts, etc.

On the other hand, commercial banks should correctly understand the time nodes of the different parts of litigation to accomplish a seamless transition in litigation time and the interlocking of the various components of litigation in order to prevent the loss of claims due to late litigation [9]. Furthermore, the performance evaluation index system for the sale of NA must be enhanced. To accomplish scientific performance evaluation and increase employee passion for their job. Finally, the application of performance outcomes should be reinforced to maximize the motivational effect of performance evaluation [10]

4.2. Government Support is Essential for the NA Disposal

Even though government involvement in the disposal of banks' NA varies worldwide, the following things are always the same: firstly, using monetary funds or government bonds to buy NA from banks would supplement banks' capital with serious problems. Secondly, active legislation can create the necessary laws to dispose of NA or grant banks certain legal concessions. Lastly, the government gives money to set up a "bad debt bank" or a financial asset management company that will run NA. Due to the indifferent idea of business credit, China's legal system is unsound, and most firms' property rights need to be more explicit. Thus, the disposal of NA in banks requires favourable administrative promotion.

5. Conclusion

NA is crucial and urgent for Chinese banks to resolve since it might diminish the banks' liquidity, safety, and profitability, making them less risk-tolerant. NA in China's banks are widespread, and internal and external factors, like national industrial policy adjustment, use of monetary funds and severe flaws in the money-operating banks' management systems, have exacerbated their longevity and magnitude. The key to solving the NA of Chinese banks is to utilize multiple disposal methods, convert the operation mechanism, and create an excellent institutional environment with the government's help. This paper does not focus on developing a bank NA solution with Chinese characteristics. Future study should thoroughly learn from foreign experience, combined with the actual circumstances in China.

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