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Bankruptcy Industry Update

China NPL Investors Call US-China Trade Deal 'Positive' Development; Agreement Unlikely to Remove Main Hurdles for Investors

Americas Core Credit Asia Core Credit

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Relevant Documents:
US-China Economic and Trade Agreement
Notice on Strengthening Supervision and Management of Provincial Asset Management Companies (Chinese)
Management Measures on Bulk Transfer of Non Performing Assets of Financial Institutions (Chinese)

Two firms that have been long-time investors in China's non performing loan market called the US-China Economic and Trade Agreement signed on Thursday a positive development. The deal, however, is unlikely to remove major hurdles for foreign buyers of NPLs, said one of the firms, ShoreVest Partners, in a letter sent to its clients Friday (Jan. 17) that was viewed by Reorg.

As reported, China has promised to allow "U.S. financial services suppliers to apply for asset management company licenses that would permit them to acquire non-performing loans directly from Chinese banks, beginning with provincial licenses." In the future, when national licenses are open for foreign buyers to apply for, China has promised to grant them equal footing with domestic players.

"For US investors that acquire a license, Beijing's concession promises to reduce the cost of acquiring NPLs, and open up access to a far broader range of NPLs," ShoreVest wrote in the letter to clients. "Of course, it remains to be seen how readily the banking regulator is willing to grant licenses."

"Equally important will be whether the regulator is willing to issue licenses in the provinces where US investors want to operate, or whether it will try to use the licenses as a way to stimulate interest in provinces that have struggled to attract interest from NPL investors," the letter continued.

Currently, there are four national licensed AMCs in China - Great Wall Asset Management, China Orient Asset Management, China Huarong Asset Management, and China Cinda Asset Management. The big four AMCs were originally established with approval of China's State Council in 1999 to remove up to RMB 1,400 billion ($203.8 billion) of NPLs from balance sheets of four major Chinese banks ahead of public listings in Hong Kong - Agricultural Bank of China, Bank of China, China Construction Bank, and Industrial and Commercial Bank of China.

Starting in 2014, the former China Banking Regulatory Commission (CBRC) began issuing licenses for provincial AMCs, which were expected to operate and compete alongside the four national AMCs, and buy NPLs directly from banks within their geographical limitations. As of 2019, there were over 50 provincial AMCs operating across China, some wholly owned by the local government, others controlled by financial institutions or private interests, according to media reports.

Based on Reorg's review of the relevant regulation governing the establishment of provincial AMCs, current prerequisites for any company that wants to obtain an AMC license include: over five years of experience in NPL management and disposal, registered capital of over RMB 10 billion ($1.455 billion), and to have already obtained licenses for financial services, unless the applicant is an AMC directly established or authorized by local government. In principle, each province should have no more than one provincial AMC, but in reality the number has been exceeded in several provinces.

The new agreement represents "a tacit acknowledgement" that Beijing is eager to see foreign NPL investors play a greater role in its banks' bad loan disposals, ShoreVest wrote.

ShoreVest said it is already in discussions with several provincial and municipal governments about potentially obtaining such asset management company licenses, noting that details have yet to be ironed out on how exactly the licenses will be granted.

“While this is a positive development, it bears noting that regulatory hurdles have never been the primary gating factor for foreigners hoping to invest in Chinese NPLs,” ShoreVest wrote, adding that for many years, foreigners have been allowed to purchase NPLs from AMCs, or to source them directly from banks and then transact through AMCs, as the firm has many times in the past.

“The primary gating factor has actually been experience, operating ability and networks for both sourcing and servicing NPLs,” the letter noted. During the current NPL cycle, as the firm has witnessed in past cycles, inexperienced foreign investors have had difficulty “turning their first NPL investments into positive exits.”

In an emailed response to an inquiry from Reorg, Ben Fanger, founder and managing partner of ShoreVest said the primary issue for inexperienced investors is their ability to obtain information on the borrowers, collateral and issues with contingent liabilities in a given NPL pool.

“Much of this information requires due diligence beyond what basic information a seller provides,” Fanger wrote in the email. “Being able to buy loans directly from banks is unlikely to resolve this issue because the issue relates to due diligence capabilities on the buyer side.”

“Regardless of whether an investor buys from a bank or AMC, the information provided by the seller is likely to be similar,” he wrote.

A source at another firm that was among the earliest buyers of Chinese NPLs said the trade deal helped create a “positive” business environment.

“We won’t worry too much about competition in the short term, given it takes some time for others to set up,” said the source. “The market is quite niche and the relevant expertise is not widely shared.”

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