

The Logic and Pathways of Stringent Financial Regulation Empowering Corporate ESG Practices

Xiaoyan Guan¹, Pengqian Zhang¹, Ningning Zhang^{2*}

¹Department of Economics and Management, North China Electric Power University, China

²Finance Department of North China Electric Power University, China

**Author to whom correspondence should be addressed.*

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Abstract: Against the backdrop of high-quality development, ESG has become a key guideline for corporate sustainability. Taking the New Asset Management Regulation introduced in 2018 as a representative policy, this paper systematically explores the internal logic, practical pathways, and challenges of how strong financial regulation empowers corporate ESG practices. From the perspective of internal logic, strong financial regulation can enhance the motivation and ability of corporate ESG practice by lowering financing costs, curbing managerial myopia, and intensifying product market competition. From the perspective of practical pathways, the New Asset Management Regulation has effectively advanced corporate ESG practices through measures such as breaking rigid payment, prohibiting multi-layer nesting, and strengthening asset maturity mismatch management.

Keywords: ESG; Strong financial regulation; The New Asset Management Regulation; Sustainable development

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1. Introduction

To strengthen the regulation of asset management (AM) activities, China implemented the Guiding Opinions on Regulating the Asset Management Business of Financial Institutions (hereinafter referred to as the “New Asset Management Rules”) on April 27, 2018. The core content of the reform includes breaking the implicit guarantee of principal and returns, restricting leverage, addressing asset–liability maturity mismatches, dismantling channel businesses and multi-layered nesting, and differentiating between standardized and non-standardized assets. The policy aims to establish unified regulatory standards and a comprehensive supervisory framework to effectively prevent financial risks and guide social funds toward the real economy. According to relevant reports, since the implementation of the New Asset Management Rules, principal-guaranteed wealth management products have been completely phased out, and multi-layered nested products have been largely eliminated. Meanwhile, the net asset value (NAV)-based management of products has been strengthened, leverage ratios and channel businesses have been significantly reduced, and the scale of shadow banking has declined ^[1]. As a result, capital idling

and financialization detached from the real economy have been fundamentally reversed, while the quality and efficiency of the asset management industry in serving the real economy have been markedly enhanced.

At the same time, greenhouse gas emissions are exacerbating climate change and environmental challenges, exerting increasingly significant impacts on global socioeconomic systems^[2]. The concept of sustainable development has gained wide recognition. As the primary actors in a market economy, corporations play an essential role in promoting high-quality and sustainable economic development through their environmental, social, and governance (ESG) performance^[3]. ESG represents a new development paradigm emphasizing environmental, social, and governance outcomes. Its requirements for corporate energy conservation, emission reduction, and green sustainable development align closely with the goals of carbon peaking and carbon neutrality, thereby serving as an effective instrument for enterprises to implement sustainable strategies. The Third Plenary Session of the 20th Central Committee of the Communist Party of China reaffirmed that Chinese modernization should achieve the organic unity of economic development and ecological civilization. Consequently, how to guide enterprises in balancing the pursuit of economic returns with social responsibility and environmental governance, thereby enhancing ESG performance, has become a critical issue for the “14th Five-Year Plan” period and beyond.

Against this backdrop, financial regulatory policies not only bear the responsibility of preventing systemic financial risks and improving financial services to the real economy, but are also entrusted with the mission of channeling resources toward green, low-carbon, and high-quality development. The goals and policy logic of stringent financial regulation and corporate ESG practices thus exhibit a convergence, making their interlinkages worthy of in-depth analysis. This study examines the theme of stringent financial regulation empowering corporate ESG practices, taking the New Asset Management Rules as the first unified regulatory framework in the asset management sector. It focuses on the internal logic, practical pathways, and real-world challenges of this policy, and explores how financial regulation can improve corporate ESG performance by lowering financing costs, curbing managerial short-termism, and enhancing external collaborative governance effects.

2. The internal logic linking stringent financial regulation and corporate ESG

2.1. Transaction cost logic

Transaction cost theory posits that enterprises face costs in searching for information, negotiating contracts, and monitoring execution in market transactions, which directly affect decision-making efficiency. By reducing transaction costs, firms can allocate resources more effectively. Financially stringent regulation can mitigate information asymmetry, guide the decline of risk-free interest rates, and direct funds toward the real economy, thereby lowering corporate financing costs and enabling greater investment in ESG.

First, alleviating information asymmetry helps reduce financing costs. On one hand, when information asymmetry is high, creditors and shareholders, unable to accurately assess a firm’s true value and risks, often demand higher returns to compensate for uncertainty. Improved information transparency reduces perceived risk, lowers risk premiums, and directly decreases the cost of debt and equity financing. On the other hand, transparent firms enjoy higher stock liquidity and stronger investor trust, which reduces the cost of equity capital. Enhanced transparency therefore optimizes the financing environment, creating a resource base for ESG practices^[4].

Second, declining risk-free interest rates lower financing costs. As a key component of lending rates, the fall of the risk-free rate directly reduces bank lending costs for firms. Simultaneously, lower expected returns on risk-free assets encourage investors to reallocate capital into riskier assets, such as corporate bonds and equities,

seeking higher yields. This shift compresses the risk premium demanded from firms, further lowering financing costs. Thus, declining risk-free rates reduce costs via both bank credit and capital market channels, providing robust resources for ESG investment.

Finally, directing funds into the real economy reduces financing costs. By curbing speculative flows into real estate and financial arbitrage, stringent financial regulation lowers systemic risk, reduces risk premiums, and decreases financing costs. In addition, greater capital allocation toward real-sector businesses increases the availability of funds for corporate ESG activities, thereby fostering sustainable development.

2.2. Behavioral constraint logic

The separation of ownership and control in modern corporations generates agency conflicts and information asymmetry, often leading to distorted managerial incentives and short-termism. Behavioral constraint theory suggests that external norms and regulations shape organizational behavior, guiding decision-making toward long-term interests and social responsibility. Stringent financial regulation can restrict financial investment channels, raise financial investment risks, and enhance transparency, thereby constraining short-termism and promoting ESG-oriented strategies.

Specifically, stringent regulation reduces opportunities for short-term financial arbitrage, compelling managers to prioritize long-term ESG investment. Furthermore, under portfolio theory, rational managers balance risk and return across investment options. As financial regulation increases the risk of financial investments, managers are incentivized to pursue sustainable growth. Lastly, by improving information transparency, stringent regulation weakens corporate financialization and agency conflicts, encouraging long-term ESG investment over short-term profit-seeking.

2.3. Market competition logic

Market competition theory argues that competitive environments generate information effects and liquidation threats, shaping managerial investment behavior. Stringent financial regulation curtails firms' ability to earn profits and expand through financial investments, forcing them to refocus on core operations and intensifying competition. This, in turn, incentivizes better information disclosure and provides favorable conditions for ESG advancement.

More specifically, stringent regulation diverts corporate capital away from financial speculation and back into core business activities, heightening industry competition. Firms are thus motivated to enhance innovation and operational efficiency. At the same time, restrictions on leveraging financial products for expansion compel companies to compete on productivity and governance. In this context, firms improve transparency and ESG performance to secure stakeholder trust and maintain competitiveness. High ESG performers are more likely to gain stakeholder support, whereas firms with poor ESG practices risk marginalization or liquidation. Hence, intensified market competition under financial regulation strengthens both information and liquidation effects, motivating firms to improve ESG outcomes.

3. Pathways of stringent financial regulation empowering corporate ESG practices

3.1. Reducing financing costs and optimizing resource allocation

The New Asset Management Rules mitigate information asymmetry, guide risk-free rates downward, and direct funds into the real economy, thereby lowering financing costs and easing ESG underinvestment. First, by imposing

look-through supervision on trust products and channel businesses, the rules restrict corporate financialization, thereby reducing information asymmetry and enhancing external financing availability. Second, breaking the rigid repayment guarantee and transitioning from amortized cost to NAV accounting improves risk reflection, adjusts market expectations, and lowers the risk-free rate, reducing financing costs^[5]. Third, prohibiting multi-layered nesting and strengthening maturity mismatch management, redirecting capital from high-yield sectors such as real estate and local government financing vehicles toward standardized assets and the real economy, further lowering costs.

3.2. Limiting arbitrage and strengthening ESG strategic orientation

The New Rules restrict channels for financialization, increase financial investment risks, and promote transparency, thus constraining managerial short-termism. Before their implementation, listed firms often relied on nested channel businesses to participate in financialized investments. The rules, through look-through regulation of ultimate investors and underlying assets, sharply curtail such practices. Moreover, by eliminating implicit guarantees, firms bear risks themselves, raising investment risks and discouraging speculative behavior. Finally, unified regulation across products reduces agency costs, enhances transparency, and steers managerial focus toward long-term ESG strategies.

3.3. Enhancing external governance pressure and driving sustainable transformation

The New Rules constrain firms' use of financial instruments for profit and expansion. Measures such as NAV-based management, the abolition of implicit guarantees, leverage restrictions, and prohibitions on capital pooling and nesting suppress high-risk, high-yield financial operations. Restrictions on structured M&A fund leverage and the prohibition of non-proprietary funds for asset management product investment further limit over-leveraged expansion. As a result, firms are compelled to reallocate resources to core business operations, intensifying competition and strengthening external stakeholder governance, which enhances ESG investment and performance.

4. Conclusion

As exemplified by the New Asset Management Rules, stringent financial regulation dismantles implicit guarantees, prohibits excessive nesting, and strengthens maturity mismatch management, thereby lowering financial market risks and channeling funds into the real economy through unified and look-through supervision. For corporate ESG practices, stringent financial regulation reduces financing costs, optimizes resource allocation, and enhances ESG capabilities; curtails arbitrage incentives, fostering ESG-oriented strategies; and intensifies market competition, reinforcing external governance pressure and motivating ESG commitment.

Nevertheless, practical challenges persist, including incomplete ESG disclosure frameworks, inconsistencies in ESG ratings, and tensions between ESG's long-term value creation and short-term performance assessments. These limitations restrict the effective empowerment of corporate ESG strategies by stringent financial regulations.

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