Impact of Institutional Environment on Fund Compliance Behavior: A Policy Shock Analysis Based on the "Performance Comparison Benchmark Guidelines"

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Abstract. China's public mutual funds face the dilemma of "funds making profits while investors do not." In 2025, the China Securities Regulatory Commission attempted to curb opportunistic behavior through institutional constraints. This paper utilizes this policy shock to examine the impact of the institutional environment on fund compliance behavior and compares the differences in policy effects across various institutional settings. The study found: First, the "Performance Comparison Benchmark Guidelines" significantly curbed fund compliance behavior. After the policy's expected effects became apparent in 2023, the lottery weighting of funds decreased by 1.137 percentage points compared to 2021, by 2.026 percentage points in 2024, and by 1.950 percentage points in 2025. Second, stock funds respond significantly stronger to policy shocks than bond funds, indicating that policy effects are more pronounced in sectors with weaker institutional environments; third, the weight allocation of bond funds is significantly lower than that of stock funds. This paper is the first to use policy shocks to examine the actual impact of institutional constraints on fund compliance behavior, providing direct evidence for evaluating the "Performance Benchmark Guidelines" and empirical support for the precise design of regulatory policies.

Keywords: Institutional Environment, Conformist Behavior, Public Mutual Funds, Performance Comparison Benchmark, Policy Evaluation.

1 Introduction

In recent years, China's mutual fund sector has experienced rapid growth. According to the latest data from the China Investment Fund Association, the net assets of publicly offered funds stood at 37.77 trillion yuan at the end of January 2026, an increase of 517.18 billion yuan compared with the end of 2025. Driven by various factors, such as growing demand for asset allocation from households and the gradual reform of capital markets, public funds – which are an important instrument of inclusive financial services – are entering a new phase of high-quality development. Behind this rapid expansion, however, lies a long-standing problem in the sector that remains unresolved: the dilemma that "the funds make profits, but investors cannot benefit from them".

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The “Research Report on the Return Gap Among Investors in Public Funds in China” highlights that there is a considerable difference between the actual returns of investors in public funds in China and the returns of the funds themselves. Data covering the five-year period up to 31 December 2024 show that the return differential for investors in equity-oriented funds is negative [1]. The main cause of this phenomenon lies in poor timing decisions made by investors: they try to capitalise on price rises and sell during falls, leading them to “buy high and sell low”, which generally results in returns lower than the fund’s actual returns.

The other side of this matter lies in the behavioural choices of fund managers. Extensive research suggests that fund managers do not fully act as rational speculators but instead work to efficiently satisfy investors' preferences. Kumar was the first to introduce the concept of “lucky stocks”, finding that investors generally prefer such stocks. Studies by Agarwal, Jiang and Wen show that funds hold lucky stocks primarily to align with investor preferences, thereby attracting larger capital inflows [2]. Research published by Wang Jian et al. reveals that when funds adopt strategies to satisfy investor preferences, they become more attractive to investors, particularly retail investors; however, this approach implicitly harms investors' interests, as evidenced by increased future risk and lower fund returns [3]. Similarly, a study by Wu and Meng, based on a sample of Chinese open-ended funds, found that fund groups encourage their subsidiaries to adopt aggressive lottery-stock investment strategies [4]. Ching et al. also document that lottery-like features harm performance and increase sensitivity to capital flows, and that fund managers serve investors' gambling preferences by favouring lottery stocks, which in turn worsens the funds' future performance [5].

The existing research reveals the catering behavior of fund managers and its harm, but it has not been clear how to effectively curb this kind of behavior, and the effect and heterogeneity of institutional constraints remain to be tested. In this regard, in October 2025, the CSRC issued "Guidelines for Performance Comparison Benchmarks of Public Offering Securities Investment Funds (Draft for Comment)", trying to restrain style drift and restrain pandering behavior with performance comparison benchmarks, which provided a quasi-natural experimental scenario for this paper. Based on this policy, this paper systematically investigates the influence of institutional constraints on fund catering behavior, which can provide empirical support for policy evaluation, differentiated supervision and industry governance.

2 Literature Review and Research Hypotheses

Behavioral economics research shows that investors have irrational preferences and affect asset pricing. Kumar put forward the concept of "lottery stock", which reflects the gambling investment tendency of individual investors; Agarwal and others found that the lottery stock portfolio was highly consistent with investor sentiment, and Wang confirmed that such behavior would reduce long-term returns [2,3]. The research on fund level shows that fund managers have obvious investor catering behavior: Polk and Sapienza found that fund managers will allocate stocks preferred by investors to attract capital inflows; Frazzini and Lamont pointed out that the expansion of fund scale is

often at the expense of long-term performance [6]. Based on the sample of China funds, Wu and Meng found that fund families generally encourage aggressive lottery stock investment strategies [4].

The existing research has confirmed the risk of catering behavior, but it mostly stays at the level of problem identification, and the empirical research on the effectiveness of institutional constraints is still insufficient. Relying on the policy impact of the Performance Benchmark Guidelines, this paper examines the inhibitory effect of institutional constraints on fund catering behavior from the perspective of policy evaluation for the first time.

The institutional environment significantly affects the effectiveness of policies. Salifu and others confirmed that the protection of law and property rights has a positive effect on the financial market; Zhou Donghua and Zhou Siyang found that information and trust mechanism can improve enterprise financing [7,8]. Suo Pengfei and others revealed that the institutional environment has a regulatory effect on the policy effect; Yang found that the influence of regulatory constraints on fund risk-taking has situational differences [9,10]. Relevant literature provides a theoretical basis for this paper to study the heterogeneity of policy effects.

Based on the above analysis, this paper proposes the following research hypotheses:

Hypothesis 1: The directive has significantly curbed the fund's compliant behaviour.

Hypothesis 2: The effectiveness of the strategies varies depending on the institutional environment.

Hypothesis 3: The proportion of bond funds in the lottery is significantly lower than that of equity funds, reflecting their advantages in the institutional environment.

3 Research Design

The data used in this study are primarily sourced from the CSMAR database and Wind Information. Information on fund portfolios, including the allocation of investments between equities and bonds, was extracted from the CSMAR fund database. Data on individual stock market transactions were sourced from the CSMAR stock market transaction database and were used to identify lottery stocks. The study period runs from January 2010 to December 2025. This study applies to Kumar's methodology to identify lottery stocks, and the results show that these stocks account for 29.97% of the total sample.

The dependent variable in this study is the weighting of "lottery" shares, which measures the weighted proportion of these shares in the fund's portfolio. The most important explanatory variables include: a year variable (with 2021 as the reference year, covering the period 2022–2025), a variable for policy shocks (fixed to 1 for 2023 and subsequent years), a dummy variable for equity funds (fixed to 1), a dummy variable for hybrid funds (set to 1) and an interaction term to test the heterogeneity of policy effects (i.e. the product of the dummy variable for the policy shock and the dummy variable for equity funds). Furthermore, the study controls for annual fixed effects and fund-specific fixed effects.

To evaluate the policy effectiveness of the Performance Comparison Benchmark Guidelines, this paper establishes the following measurement model:

Model 1: Policy Effect Test (Year dummy variable)

$$LotteryWeight_{it} = \alpha + \beta_1 \times Year2022_t + \beta_2 \times Year2023_t + \beta_3 \times Year2024_t + \beta_4 \times Year2025_t + \mu_i + \varepsilon_{it} \quad (1)$$

The coefficientsβ_2,β_3, and$\beta_4$measure the changes in lottery weights for 2023 and subsequent years compared to 2021.

Model 2: Test of the Policy Shock Virtual Variable

$$LotteryWeight_{it} = \alpha + \theta \times Post2023_t + \mu_i + \varepsilon_{it} \quad (2)$$

The coefficientθmeasures the average change in lottery weights before and after policy implementation.

Model 3: Test for Heterogeneity of Fund Types

$$LotteryWeight_{it} = \alpha + \beta_1 \times StockFund_i + \beta_2 \times MixedFund_i + \gamma_1 \times Year2022_t + \gamma_2 \times Year2023_t + \gamma_3 \times Year2024_t + \gamma_4 \times Year2025_t + \mu_i + \varepsilon_{it} \quad (3)$$

Model 4: Double Difference Model

$$LotteryWeight_{it} = \alpha + \theta \times Post2023_t + \delta \times StockFund_i + \eta \times (Post2023_t \times StockFund_i) + \mu_i + \varepsilon_{it} \quad (4)$$

The interaction term coefficientηmeasures the difference in policy response between equity funds and bond funds.

4 Empirical Results and Analysis

4.1 Descriptive Statistics

As shown in Table 1, bond funds have the lowest weight allocation, while equity funds have the highest, with hybrid funds falling in between. This reflects differences in institutional environments across markets—the bond market, dominated by institutions and supported by well-established frameworks, exhibits stronger resilience against speculative behavior.

Table 1. Weight distribution statistics by fund type and lottery category.

Fund Type	observed value	mean value	standard deviation	median
Stock Type	2,479	3.112	4.521	1.382
Bond Type	2,463	2.298	2.232	1.578
Mixed Type	19,971	2.855	3.536	1.746

4.2 Policy Effect Testing

As shown in Table 2, the coefficient was not significant in 2022 (p=0.245), indicating no significant change in policy expectations prior to that year; the coefficient was-1.137 in 2023, significant at the 1% level; -2.026 in 2024, also significant at the 1% level; and-1.950 in 2025, remaining significant at the 1% level.

This result supports Hypothesis 1. The Performance Comparison Benchmark Guidelines significantly curb fund catering behavior. After the anticipation effect of the 2023 policy emerged, the lottery weight of funds continued to decline significantly.

Table 2. Policy effect test: year dummy variable

variable quantity	ratio	standard error	t value	p value
$Year2022_t$	0.048	0.0409	1.16	0.245
$Year2023_t$	-1.137	0.0531	-21.42	0.000
$Year2024_t$	-2.026	0.0570	-35.54	0.000
$Year2025_t$	-1.950	0.0601	-32.42	0.000
α	3.112	0.0394	79.00	0.000

4.3 Heterogeneity Test for Fund Types

As shown in Table 3, the table presents the results of a fixed-effects regression that accounts for heterogeneity across asset classes, with bond funds serving as the reference group. The coefficient for equity funds is 0.814 and is significant at the 1% significance level; the coefficient for balanced funds is 0.557 and is also significant at the 1% significance level; bond funds have the lowest weighting; and the annual effect is constant across the entire sample.

This finding supports Hypothesis 3: the "lottery-like" weight of bond funds is significantly lower than that of equity funds, reflecting their structural institutional advantages. This finding stems from the inherent institutional differences between the bond market and the equity market. On the one hand, the bond market is dominated by institutional investors, with relatively low participation from retail investors; its investor base is more rational, which results in less speculative demand for risky securities and, consequently, less incentive for fund managers to cater to such preferences. On the other hand, the bond market is characterised by a well-developed market-making mechanism and more robust liquidity management, while bond funds have clearer investment objectives and risk limits, which impose stricter constraints on the allocation to high-risk and highly asymmetric assets. As they operate in a relatively mature institutional environment, bond funds therefore essentially have the ability to limit this type of speculative behaviour.

Table 3. Heterogeneity test for fund types

variable quantity	ratio	standard error	t value	t value
$StockFund_i$	0.814	0.1015	8.02	0.000
$MixedFund_i$	0.557	0.0730	7.63	0.000

$Year2022_t$	0.048	0.0409	1.16	0.245
$Year2023_t$	-1.137	0.0531	-21.42	0.000
$Year2024_t$	-2.026	0.0570	-35.54	0.000
$Year2025_t$	-1.950	0.0601	-32.42	0.000
α	2.298	0.0394	58.32	0.000

4.4 Double Difference Test

As shown in Table 4, the results of the difference-in-differences analysis indicate that the coefficient of the dummy variable for the policy shock is -1.102 and is significant at the 1% significance level; the coefficient of the dummy variable for equity funds is 0.814 and is also significant at the 1% significance level; the coefficient of the interaction term is -0.355 and is significant at the 1% level. This can be explained by inherent institutional differences between the bond market and the equity market: the bond market is dominated by institutional investors and has a well-developed market-making mechanism, which by its nature places greater constraints on speculative behaviour. The significantly negative interaction term suggests that equity funds react more strongly to policy shocks than bond funds. The lottery weight of equity funds decreased by 0.355 percentage points more than that of bond funds after the policy intervention. These results support Hypothesis 2: equity funds operating in less favourable institutional environments react more strongly to political shocks, and institutional constraints are more pronounced in markets where regulatory oversight is weaker.

Table 4. Double difference tests

variable quantity	ratio	standard error	t value	t value
$Post2023_t$	-1.102	0.0482	-22.86	0.000
$StockFund_i$	0.814	0.1015	8.02	0.000
$Post2023_t \times StockFund_i$	-0.355	0.0863	-4.11	0.000
α	2.298	0.0394	58.32	0.000

Based on the findings outlined above, this article assesses the policy impact of the "guidelines on benchmarking criteria for performance comparison" as follows.

Firstly, this policy has proved effective. As soon as its expected effects became apparent in 2023, the share of funds allocated to lottery-related assets fell significantly — by 1.137 percentage points in 2023, by 2.026 percentage points in 2024 and by 1.950 percentage points in 2025. The test using dummy variables for policy shocks revealed an average decline of 1.457 percentage points. Secondly, the policy effects showed heterogeneity: equity funds operating in less favourable institutional environments reacted more strongly to policy shocks, and the magnitude of their reaction exceeded that of bond funds by 0.355 percentage points. This suggests that institutional constraints have a more pronounced effect in markets where regulatory oversight is weak. Thirdly, the effects of the policies persisted from 2023 to 2025, intensifying further in 2024 and remaining at a high level in 2025.

5 Conclusion

The results of this paper show that the policy significantly inhibits the fund's catering behavior, and the expected effect appears since 2023, and the positions of lottery stocks continue to decline; The policy effect is heterogeneous, and the decline of stock funds with weak institutional environment is significantly greater than that of bond funds with more perfect institutions; The bond fund itself has a lower lottery weight, which reflects the natural constraint of the bond market on catering behavior. This shows that the guidelines effectively curb the speculative behavior of fund managers by strengthening the performance benchmark constraints, and the effect is more prominent in areas with weak supervision, which provides a basis for differentiated supervision.

Accordingly, this paper puts forward the following suggestions. Strengthen the supervision of stock fund style drift and regularly disclose over-standard products; Pay attention to policy heterogeneity and focus on strengthening supervision in weak areas; Popularize the mature institutional experience of the bond market and optimize the investor structure and market maker mechanism of the stock market; Improve the fund assessment system, and link long-term performance with benchmarks into salary incentives.

The limitation of this paper is that it only examines the direct effect of policies, fails to test the intermediary mechanism of "salary assessment-behavior change", and does not consider the regulatory role of internal governance of fund companies. In the future, people can carry out long-term follow-up research, introduce intermediary and adjustment models, and further reveal the policy transmission path and boundary conditions.

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