



Research on the Long-Term Mechanism for Chinese Commercial Banks' Risk Prevention

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Abstract

Under the background of global financial crisis, Chinese commercial banks suffer from significant economic losses and negative social influences due to frequently happened risks. To prevent risks tends to be more urgent. This paper starts from risks in front of Chinese commercial banks under the financial crisis, analyzes problems in Chinese commercial banks constructing risk prevention long-term mechanism, and advances countermeasures for expediting the construction of risk prevention long-term mechanism.

Keywords: Financial crisis, Commercial bank, Risk prevention, Long-term mechanism

1. The main risks in front of Chinese commercial banks under the financial crisis

For a long period, Chinese commercial banks face problems of poor assets quality and low assets reorganization rate. Under the background of global financial crisis and China's imperfect financial market, commercial banks do not possess perfect risks management system. More risks exist in both risks evaluation and prevention and internal control.

1.1 Risks of financial innovation

Chinese commercial banks lack of initiatives in product design and pricing and lay less stresses on product development and brands, which leads to a serious product homogenization and an absence of core competitiveness. Therefore, all commercial banks have the problem of financial innovation. Because of restrictions in system, technologies, and macro policies, presently Chinese commercial banks' financial innovation mainly focus on quantities. The type of financial innovation is few and the scale is small. Innovations concern all fields of commercial banks but mostly are introduced from western countries directly. Few are originated from China.

1.2 Risks of financial credit

Some commercial banks fail to follow the principle of matching customers' interests and risk-bearing capabilities as they design financial products. They do not develop products and design portfolio in perspective of asset allocation, or predict the return of financing portfolio by scientific and reasonable measures, or build market risk supervision indexes and effective market risk identification, assessment, supervision, and control system. "Do not perform customer evaluation effectively". Supervision and regulatory institutions find that some commercial banks do not perform customer risk preference evaluation or do it carelessly, do not understand customers' financial conditions, investment goals, investment experiences, risk recognition, and risk bearing capability exactly, do not evaluate whether recommended financing products are suitable for customers or not and inform relevant suggestions to customers.

1.3 Risks of financial operation

At present, due to the loose financial regulation, business globalization, fast financial innovation, and fast development of information technology, commercial banks face growing operational risks. The greatest difficulty for Chinese commercial banks' operational risk management is the personnel management. Because the internal control mechanism in Chinese banks is still imperfect, together with the corruption during the transformation of society, it is time consuming to build the consciousness of operational risks in banking industry. It is well-known that the most frequently happened operational risk is personnel risk. Illegal operations are common.

2. The problems in Chinese commercial banks' risk prevention

2.1 Lagged behind risk management idea

Because Chinese commercial banks' risk management starts later, risk management professionals can not catch up with

the fast developed businesses and constantly changing risk management in the aspect of risk management idea. In specific, it focuses on two points. On one hand, some initial workers usually position risks at the opposite of business development. They can not recognize and evaluate risks properly. They think risk management stops business development. On the other hand, some risk management professionals can not research businesses, markets, and efficiencies. They think that to develop business can control risks. And they pursue business indexes to much and neglect risk management, what cause that valuable business can not develop properly, decreasing banks' capabilities of risk prevention.

2.2 Immature risk prevention technology

Presently, a chief characteristic of risk prevention in world banking industry is to use statistical methods and information technologies to realize quantitative management. In foreign countries, some advanced banks have already completed a set of control system, including risk identification, risk grading, risk supervision, risk pre- warning, and risk avoidance systems. In contrast, China lags far behind in this field. Concerning risk management, Chinese commercial banks emphasize on qualitative analysis and lack of quantitative analysis. Risk identification and evaluation are inexact. The degree of information dig-out is low. And data accumulation starts recently, plus too much and separate branches and workers, some policies and relevant information can not be communicated and collected exactly, rapidly, and comprehensively, what lead to incomplete and inexact basic data. Many foreign mature risk prevention tools still fail to exert effects on Chinese banks' risk prevention now.

2.3 Imperfect internal control of risk management

Internal control is the base of risk management. Although Chinese commercial banks build a set of internal control, the imperfect organizational structure of internal control and incomplete internal control measures cause such a result that internal control merely depends on some functional departments in practical operations. There are no necessary supervisions and restrictions, comprehensive coordination and cooperation, and effective incentive- restriction mechanism between functional departments. The absence of self-restricting mechanism causes that commercial banks can not restrict capital utility by capital sources. As a result, banks issue loans without strict standards, what leads to shortage of capitals, low rate of capital sufficiency, and weak capability of risk prevention.

2.4 Powerless financial supervision and regulatory

Financial liberalization and financial innovation are motives for financial development, which can significantly drive the development of finance and financial market on one hand. On the other hand, they bring about more risks for financial system. That means higher requirements for financial supervision and regulatory. Since the foundation of China Securities Regulatory Commission, China Insurance Regulatory Commission, and China Banking Regulatory Commission, China applies the financial separating management system, what is determined by the present development of finance in China. Under this system, three dominating commission fulfill their commitments. They merely focus on special financial institutions respectively, without sufficient coordination, which leads to repetitive or virtual regulatory. China's present regulatory system can not catch up with the financial globalization due to the poor capability of risk prevention. To strengthen multi-national regulatory cooperation has become more and more important. Therefore, it is necessary to enhance the coordination and cooperation of financial regulatory institutions, forming a comprehensive regulatory system.

3. Strengthen the long-term mechanism for Chinese commercial banks' risk prevention

3.1 Build scientific development view and advanced business idea

The coordinative development of benefit, quality, and scale are basic contents of Chinese commercial banks' scientific development view at present. To insist on the coordinative development of benefit, quality, and scale means to adjust the traditional development mode popularized for years, which pursues for the fast extension of loans. With the precondition of guaranteeing quality, actualize the long-term stable growth of profits by enlarging the scale properly. To build advanced business idea is to recognize and accept western commercial banks' some advanced business ideas: "Banks should survive from risk prevention. Their values are realized by effective risk management." "Interests from loans are not merely deposit-loan interest margin or profit. They are kind of compensation for risks taken by banks because of issuing loans to borrowers." In these ideas, the key concept "risk compensation" is applied to whole credit approval and management process. Meanwhile, in order to deal with the relationship of risk prevention and business development, we should realize that there is no conflict between risk prevention and business development. The risk prevention process is also a value creating process. Any business faces risks. The task of risk prevention is to seek for the risk in business process, evaluate the risk, and prevent risk by adopting positive measures. Create benefits in the process of controlling risks.

3.2 Improve commercial banks' risk management methods

The key for commercial banks controlling risks is to improve the identification and evaluation of market risk, which

depends on theories, complex software system, and powerful database. Chinese commercial banks should completely recognize, exactly assess, continuously supervise, and properly control the market risks in all trades or non-trade businesses, insuring a stable operation under acceptable market risk level. Commercial banks should build a market risk management systems that are suitable for business nature, scale, and complexity, differentiating risks at different levels by designing reasonable credit grades. Commercial banks should appoint a special department that is in charge of market risk management, organically combining all business management activities, including market risks' identification, assessment, supervision, and control, and general strategic program, business decision, and financial budget. Assess risks reasonably by qualitative and quantitative grading methods. Along with changes of global financial environment, commercial banks' risk management concerns not just credit risk. It is necessary to strengthen the supervision on market risk and liquidity risk. According to market changes, adjust tactics in time and avoid risks.

3.3 Strengthen financial institutions' internal control

Financial institutions' internal control is very important for preventing financial risks. Effective internal control is more useful for risk prevention. To strengthen internal control, we can start from these three aspects:

(1) Establish business guidance, and make up work regulations differentiating rights and responsibilities clearly. Financial institutions should establish clear business guidance based on laws, regulations, and rules. All departments and branches can make up relevant work objectives according to business guidance, insuring to actualize the general business benefits. Meanwhile, make up regular position responsibility system, strict operation procedure, and reasonable work standard, endowing each position with relevant responsibilities and functional rights. Build a mutual cooperative and supervising work relationship.

(2) Build effective internal check system. Internal check system is a continuously checking system during the operation of all departments and positions. In other words, as one operation is done, it has checked the former operation at the same time. Effective internal check system can reduce work mistakes, drive mutual supervision between positions, and decrease risks. Meanwhile, all positions should improve the consciousness of prevention, form customer information database, and check borrowers' credits, in case of bad debts.

(3) Build effective pre-warning and prediction system. The pre-warning and prediction system mainly focuses on suggesting internal control for all operations, checking and evaluating all departments' internal control, assessing the execution of internal control, and punishing the departments or individuals who violate the internal control.

3.4 Form an integrated regulatory system and enhance the international cooperation of financial regulatory

(1) Integrate the regulatory system

Along with the opening-up of finance, the integration of finance, and the development of financial holding company, the transformation from a separating regulatory to an integrated regulatory is the ultimate trend. To integrate the regulatory system needs to integrate the regulatory resources of finance, securities, and insurance. Simplify institutions, optimize regulatory organizational structure, build an effective and efficient financial regulatory team, and actualize the general constitution and execution of financial regulatory policies. By this way, it can completely delete problems, such as low efficient regulatory, useless regulatory, and repetitive regulatory, caused by separating regulatory on one hand. On the other hand, it can improve the effectiveness and comprehensiveness of regulatory, driving innovations of finance and the stable development of finance, benefiting the general competitiveness of Chinese finance, and preventing financial risks and financial crisis.

(2) Enhance the international cooperation of financial regulatory

During the key period for the all-round opening-up of finance in China, Chinese financial institutions should enhance the international cooperation and coordination of financial regulatory, preventing world financial risks carefully, strengthening regulatory on multi-national capital flow, and promoting financial opening-up stably. As for the world financial system, it is necessary to build an emergency and aid mechanism for global financial crisis, strengthen the coordination of world financial regulatory, and completely exert the effects of newly-developed market economic body on world financial organizations.

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