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Challenges and Countermeasures to Prevent and Resolve Financial Risks

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Authors' contributions

This work was carried out in collaboration between both authors. Author CZ designed the study, performed the statistical analysis, wrote the protocol and wrote the first draft of the manuscript. Authors CZ and ZF managed the analyses of the study. Author ZF managed the literature searches. Both authors read and approved the final manuscript.

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Opinion Article

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ABSTRACT

Preventing and resolving financial risks has a bearing on national security, overall development, and people's property security. It is a battle that cannot be lost. 2020 is the most crucial year to win the battle against major risks. As a core component of China's financial system, banking financial institutions bear the main responsibility of preventing and controlling financial risks, and they are also the main force in preventing and defusing financial risks. In the past period of time, banking financial institutions have implemented different strategies for different risks, accurately detonated bombs, and achieved phased goals. The rapid growth of non-performing loans has been contained, but there are still some potential risks that cannot be ignored. Therefore, from the perspective of preventing systemic risks, the task of winning the formidable battle is still very arduous, and it needs to be fully motivated and go all out to resolve the risks.

Keywords: Challenges and countermeasures; financial risks; potential risks.

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1. CAUSES OF FINANCIAL RISKS

At present, the sources and risks of global economic and financial turbulence are still increasing, the downward pressure on the domestic economy has increased, and potential risks may continue to be exposed. In the practice of preventing and defusing financial risks, we have a deeper understanding of the causes of risks [1]. The current financial risks are the result of the superposition of cyclical, structural, and institutional contradictions in China's economy against the background of the spread of the impact of the international financial crisis. Specifically, it mainly includes the following aspects.

Second, there are still deficiencies in the financial governance mechanism. The macro-prudential policy framework is inadequate, laws and regulations on financial risks and the disposal of problematic institutions are still incomplete, and the central and local authorities, as well as some businesses and products, have unclear power oversight. The effectiveness of micro-regulation needs to be further improved, and early correction of operating behaviors of financial institutions that deviate from regulatory requirements is required. Some local governments ignored and underestimated risk prevention while promoting development, which led to the formation and accumulation of financial risks to a certain extent [2].

Third, some financial institutions deviated from their original intentions and main businesses, and corporate governance was imperfect. In recent years, the development concepts of some financial institutions have deviated from their original intentions and main businesses, blindly greedy for growth, and increased speculation. The principals of the party committees of some financial institutions failed to play a leading role effectively, improper selection and employment of personnel, and emphasis on scale and light risk. The corporate governance of financial institutions is weak, the "three associations and one level" are not in place, and there is no effective check and balance mechanism [3].

Fourth, external uncertainties increased, and downward pressure on the economy increased. The current deep-seated contradictions in the operation of the world economy have not been fundamentally resolved, economic growth has continued to slow down, and the sources of global turbulence and risk points have increased. Sino-US economic and trade frictions may remain long-term and complicated. From a domestic perspective, investment tends to be cautious, consumption growth faces challenges, and export growth is sluggish. The combination of external uncertainties and increasing downward pressure on the domestic economy has become a "catalyst" for financial risks.

2. THE FINANCIAL RISKS AND HIDDEN WORRIES FACING CHINA

After ten years of rapid economic and financial development, structural, institutional, and cyclical issues such as the emergence of debt risk in our country, increased downward pressure on the economy, the concentration of risks in the financial sector, and the weak social credit environment should be closely intertwined, and should be of great concern.

2.1 Debt Risk Appears, Financial Supply is Disconnected from the Real Economy

First, from the perspective of total volume, the scale of debt has increased and the growth rate is fast, and debt risk has become an important source of vulnerability of the financial system. China's macro leverage ratio rose from 141.3% in 2008 to 251.1% in the third quarter of 2019. Although the growth rate of macro leverage has slowed down since 2019, it is still at a high level.

Second, from the perspective of structure, the debt level of the corporate sector is too high, and the debt of the residential sector has grown too fast. The debt pressure of state-owned enterprises, the real estate industry, and local governments is particularly prominent. From 2008 to the end of the third quarter of 2019, the leverage ratio of the non-financial corporate sector increased from 96.3% to 155.6%, of which the asset-liability ratio of the state-owned industrial enterprises reached 58.4%, which was 1.5 percentage points higher than the total asset-liability ratio of all industrial enterprises; the private sector The asset-liability ratio of industrial enterprises reached 57.9%, an increase of 1.5 percentage points in 2019 alone; the leverage ratio of the residential sector increased from 17.9% to 56.3%, with an average annual increase of 3.5 percentage points, mainly due to the rapid rise in housing prices and the substantial increase in housing loans; In the long run, excessive residential leverage will have a crowding-out effect on consumption and investment, curbing the rate and quality of economic growth; the leverage ratio of government departments has increased from 27.1% to 39.2%, of which the central government debt risk is generally controllable. And local governments' debts have risen rapidly due to assessment mechanisms, soft budget constraints, and the "four trillion" stimulus plan. Local government debt is mainly invested in medium and long-term infrastructure projects, with long investment cycles and slow returns. Local governments have various ways to raise debt. Shadow banks and local investment and financing platforms have become important sources of funding, making it difficult to identify hidden debt risks.

2.2 Structural Policy Factors are Intertwined, and Risks are Concentrated in the Financial Field

First, the narrow financing channels lead to excessive concentration of risks. As of the end of 2018, China's real economy was dominated by loans, which accounted for 80% of indirect financing, 3% of equity financing, 14% of bond financing, and only 17% of direct financing, far lower than the proportion of direct financing in the United States (87%). In 2018, China's M2 was 182.67 trillion yuan and M2 / GDP was 202.9%, ranking first in the world. The scale of commercial bank loans increased from 17 trillion yuan in 2003 to 161 trillion yuan in 2018, an increase of 9 times. Relative to the size of the economy, China's leverage ratio and loan placements have been relatively high [4].

The second is the accumulation of risks in the real estate industry in the financial sector. The bank's credit exposure to real estate is relatively concentrated. At the end of the third quarter of 2019, real estate loan balances accounted for 28.9% of various loan balances; some housing companies raised funds through non-bank channels such as trusts and asset management plans, with multiple layers of nesting and complex models. There are many potential cross-cutting risks; fluctuations in the real estate market can easily transfer risks to the financial system by affecting the value of loan collateral and the operating efficiency of upstream and downstream industries [5].

Third, the adjustment of macro policies put pressure on the quality of financial assets. In 2015, the central government began to implement the supply-side structural reform of "three eliminations, one reduction and one supplement". "De-leveraging" has accelerated the rhythm of risk exposure. "Cost reduction" requires banks to make profits to the real economy, and "compensating for shortcomings" requires banks to provide debt financing support, which has increased the operating pressure of banks to a certain extent increased difficulty [6].

The fourth is to speed up financial opening up and bring new challenges. In recent years, China has accelerated the pace of opening the financial industry to the outside world. Banks, securities, and insurance industries have successively launched a new round of opening-up measures. The pace of entering the Chinese market has accelerated. This not only poses challenges to the operational management and risk prevention and control of China's financial institutions, especially small and medium-sized institutions, but also increases the complexity of financial supervision and policy coordination.

Fifth, the rapid development of financial technology has made it more difficult to prevent and control risks. Increasing correlation between market entities, exacerbating risk transfer across industries, markets, and regions; some Internet financial services are out of financial supervision or use regulatory gaps to arbitrage, asymmetric and disorderly development; financial transactions and information storage Highly dependent on centralized IT infrastructure, while improving efficiency, it also brings potential systemic risks.

2.3 Weak Social Credit Environment and Imperfect Long-term Risk Prevention and Control Mechanism

First, the credit information infrastructure is not in place. On the one hand, the government and commercial institutions have accumulated a large amount of data, which provides a good foundation for the construction of the credit reporting system; on the other hand, due to industry information barriers and commercial banks are not authorized to combine various types of information, the borrower has a relatively complete credit reporting there are still missing. In order to guarantee the quality of loans, banks tend to focus on guarantees or mortgages, and it is difficult to implement credit loans. If relying solely on administrative means to guide banks to increase credit loans, it will increase credit risk and be difficult to sustain.

Second, the social integrity environment needs to be improved. Some debt-earning companies take advantage of individual flaws in the loan policy and maliciously owe their debts. Local governments must mediate out of stability considerations, resulting in the inability to repay the loans, and the basic concept of "borrowing debts to repay money" cannot be upheld. The corporate governance of some enterprises is not sound, the distinction between public and private companies, corporate bankruptcy and evasion of debts, and the phenomenon of "rich monks and poor temples" are still rampant. Once the dishonesty of enterprises is not punished, it will bring contagious effects and will seriously damage regional finance Ecology affects the continuous supply of credit resources [7].

Third, the lack of transparency in accounting information. At present, the system of China's listed companies lacks transparency. Listed companies often deliberately simplify key information such as the cause of losses and related transactions, and inadequate disclosure of accounting information; lagging information disclosure, fabricating false information, and deceiving investors are abundant. Accounting information cannot accurately reflect the development of the real economy, which may cause government departments, regulators, and investors to make wrong decisions.

China’s current macro leverage ratio is generally high, and some economic entities have weak debt repayment capabilities. Due to the combined effects of structural, policy, and cyclical factors, risks in the economic field are being concentrated in the financial field and are accelerating. Trends, especially some small and medium banks have shown signs of difficulty in continuing operations [8].

3. SUGGESTIONS ON PREVENTING AND RESOLVING MAJOR RISKS IN CHINA

To prevent and control risks scientifically and to handle the dialectical relationship between the symptoms and the root causes, we must grasp four basic principles: First, return to the root cause, obey the service of economic and social development, and avoid the risk of financial degeneration and self-circulation breeding, magnifying, and spreading. The second is to optimize the structure, improve the financial institution, financial market, and financial product system, and consolidate the micro foundation for risk prevention and control. The third is to strengthen supervision, improve the ability to prevent and resolve financial risks, and minimize the impact of financial risks on the economy and society. Fourth, it is market-oriented, giving play to the decisive role of the market in the allocation of financial resources, and reducing the distortion of market mechanisms caused by various interventions.

The first is to strengthen financial services in the real economy. Finance and the real economy are a symbiotic and mutually beneficial relationship. Serving the real economy is the foundation of financial undertakings and a fundamental measure to prevent financial risks. Create a good monetary and financial environment for the development of the real economy. We must work hard to strengthen and improve financial regulation, adhere to the main line of supply-side structural reforms, take the issue of financing difficult and expensive as a starting point, strengthen coordination and coordination of monetary policy and other relevant policies, and stabilize growth, promote reform, adjust the structure, People's livelihood and risk prevention have formed a joint control force. Return to the origin of financial services in the real economy. The financial industry should focus on its main business, focus on the development of inclusive finance, technology finance and green finance, and guide the allocation of more financial resources to key areas and weak links in economic and social development. Strengthen the responsibility of financial institutions to prevent risks. It is necessary not only to shape the health of the balance sheets of financial institutions, but also to promote the health of corporate governance, internal control systems, and clearing of complex financial product transactions. It is necessary to strictly control market access, strengthen the qualification management of financial institutions' shareholders, and prevent the transmission of benefits, internal transactions, and interference in the operations of financial institutions. Establish and improve the regulations and supervision of financial holding companies, strictly restrict and regulate non-financial enterprises' investment in financial institutions, and institutionally isolate the industrial and financial sectors. Promote the reform of corporate governance of financial institutions, and effectively assume the main responsibility for risk management and curbing the emergence of major cases.

The second is to deepen the reform of financial markets and optimize the structure of social financing. Actively and orderly develop equity financing and steadily increase the proportion of direct financing. Expand multi-level, diversified, and complementary equity financing channels, reform the stock issuance system, reduce market price (index) intervention, and eliminate the root cause of profit transmission and corruption. Strengthen the protection of the rights and interests of small and medium investors, and improve the market-oriented M & A and reorganization mechanism. Make good use of the market-oriented legalized debt-to-equity weapon, develop diversified investment entities such as private equity investment funds (PE), and effectively help enterprises reduce leverage and promote the "zombie enterprise" market clearing. Actively develop the bond market, expand the scale of bond financing, enrich the variety of bond markets, and unify regulatory standards to better meet the needs of different companies in issuing bonds. Deepen market connectivity and improve financial infrastructure. Expand the risk protection function of the insurance market and guide the healthy development of the futures market.

The third is to continuously expand financial opening to the outside world and promote competition for optimization and prosperity. Recognize the significance of opening up from a higher level, adhere to the general direction of opening up to the outside world, continue to promote relevant policy reforms, and better realize the opening of the "troika": First, the opening up of trade and investment. The second is to deepen the reform of the RMB exchange rate formation mechanism. It is necessary to be proactive and make solid progress, and to take advantage of the current situation and come naturally. The third is to reduce foreign exchange control, steadily advance the internationalization of the renminbi, facilitate foreign economic activities, and securely and orderly convertible capital accounts. At the same time, on the premise of maintaining financial security, relax market access restrictions for overseas financial institutions, and promote the further integration and improvement of financial market regulations and international standards based on national conditions.

The forth is to improve the financial supervision system and strengthen overall coordination. The central regulatory authority should coordinate and coordinate. The State Council's Financial Stability Development Committee was established to strengthen the responsibilities of the People's Bank in macro-prudential management and systemic risk prevention, and effectively implement departmental supervision responsibilities. Make full use of the institutions and strengths of the People's Bank of China to coordinate systemic risk prevention and control and supervision of important financial institutions, clarify the subject of supervision, implement supervision responsibilities, and comprehensively supervise important financial institutions for financially-operating financial holding companies, cross-market and cross-industry financial products. Infrastructure, coordinate comprehensive statistics of the financial industry, comprehensively establish a framework for functional supervision and behavioral supervision, and strengthen comprehensive supervision. Coordinate policy intensity and rhythm to prevent superimposed resonance. Central and local financial management must be coordinated. Give play to both the central and local enthusiasm, the national game of chess, supervision without dead ends. The central financial supervision department conducts unified supervision guidance, formulates unified financial market and financial business supervision rules, effectively supervises local financial supervision, and corrects accountability. The local government is responsible for the risk prevention and disposal of local financial institutions, maintaining the financial stability of the territories, and may not interfere with the autonomous operation of financial institutions. Strict supervision of licensed institutions and resolute ban on illegal financial activities must be coordinated. Financial supervision departments and local governments should strengthen the control of the source of financial risks, insist that finance is a franchise industry, and must not operate without a license or operate beyond the scope. One hand is to seize financial institutions to engage in the same industry, increase leverage, do off-balance-sheet business, arbitrage in violation of laws and regulations, and one hand is to illegally raise funds, set up trading venues and other illegal financial activities that seriously disrupt the order of the financial market. Promote the special rectification of Internet financial risks in a stable and orderly manner. Regulatory powers and responsibilities should be coordinated. Establish layers of responsible business supervision and accountability systems.

4. CONCLUSIONS

If market players are dynamic, we will be able to strengthen the internal driving force for development and withstand the downward pressure on the economy. We need to vigorously promote reform and opening, accelerate the establishment of a unified, open and modern market system with orderly competition, ease market access, strengthen fair oversight, and create a law-based, international and convenient business environment to make all types of market players more active.

Several financial people believe that the balance between steady growth and risk prevention means that regulators should objectively and neutrally understand the role of shadow banking, and should not only guard against the risks of shadow banking, but also play the positive role of shadow banking. Under the current domestic financing pattern, it will help alleviate the financing difficulties of private enterprises, promote the transformation of wide money into wide credit, and the market liquidity will be better.

Managing the relationship between the government and the market well means that regulators should respect the market more, respect and follow the rules, and avoid the bad tendency of movement and one-size-fits-all in the implementation of policies. The market vitality will be better.

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COMPETING INTERESTS

Authors have declared that no competing interests exist.

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