

# *Research on the impact of new capital regulations on rural commercial banks*

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**Abstract:** Rural business behavior to carry out the "agriculture, rural areas and farmers" work and rural revitalization strategy provides a strong financial support. The Measures for the Capital Management of Commercial Banks (hereinafter referred to as the new capital regulations) have put forward new requirements for the operation and risk management of rural commercial banks, and brought far-reaching influence to the local financial institutions, which play a key role. This paper deeply discusses the specific impact of the new capital regulations on rural commercial banks, and puts forward targeted development suggestions to help rural commercial banks better adapt to the requirements of the new regulations, realize sustainable development, improve the quality and efficiency of serving "agriculture, rural areas and farmers", and make greater contribution to rural revitalization.

## 1. Foreword

Order No.4 of the State Administration for Financial Regulation on October 26,2023 promulgated the Measures for the Capital Management of Commercial Banks (hereinafter referred to as the New Regulations on Capital), which will come into force on January 1,2024. Basel Accord, an important standard for international banking regulation, aims to improve the capital adequacy ratio and risk management capacity of banks to ensure the safety and stability of the banking system. Under the framework of Basel Accord, commercial banks need to implement stricter capital regulatory requirements, including increasing capital adequacy ratio, introducing counter-cyclical capital buffer, limiting leverage ratio and so on. The implementation of the new capital regulations is to better adapt to the actual situation of China's economy, and to be in line with the international banking regulatory standards and rules. Compared with the current measures, the new capital regulation system takes into account the characteristics and risk characteristics of China's banking business, makes full use of the discretion granted by Basel Accord, the design of rules takes into account the actual situation and long-term development of banks, reflects Chinese characteristics and regulatory innovation, and improves the pertinacity and effectiveness of supervision[1].

Strengthening agriculture and strengthening the foundation is the foundation for the livelihood of the people. Since the 18th National Congress of the CPC, General Secretary has provided a fundamental guideline for firmly following the path of socialist rural revitalization with Chinese characteristics. He has delivered a series of important speeches and made important instructions and instructions on the work related to agriculture, rural areas and farmers, especially the implementation

of the rural revitalization strategy. Rural commercial banks have a close relationship with "agriculture, rural areas and farmers". As an important force to support rural economic development and rural revitalization, it is particularly noteworthy due to the influence of the new capital regulations. The implementation of the new capital regulations not only puts forward new requirements for the risk management and business development of rural commercial banks, but also provides new opportunities for them to support the rural revitalization strategy. Therefore, this paper aims to study the specific impact of the new capital regulations on rural commercial banks, and discuss how to do a good job in the work of "agriculture, rural areas and farmers" under the background of the current economic era.

## 2. Literature review

As an important financial institution serving "agriculture, rural areas and farmers", the role of rural Commercial Bank has attracted wide attention in academia at home and abroad. Most scholars believe that rural commercial banks play an irreplaceable role in promoting agricultural development, increasing farmers' income and promoting rural economic development[2]. With the change of the financial market and the adjustment of regulatory policies, the implementation of the new capital regulations has put forward higher requirements for rural commercial banks.

With the constant change of financial market and the update of regulatory policies, the implementation of new capital regulations has put forward higher requirements for rural commercial banks. Some scholars believe that the new capital regulations require rural commercial banks to improve their capital adequacy ratio, optimize their asset quality and strengthen risk management, which means that rural commercial banks need to make deep adjustments to their business strategies and risk management[3].

Facing new challenges and new opportunities, how should adjust their business strategies, scholars give some different views. Relevant scholars point out that rural commercial banks should innovate credit products, optimize financial services, and broaden their income sources. At the same time, the level of risk management should also be improved to ensure the steady development[4]. In order to better support the development of rural commercial banks, the relevant departments should also take corresponding measures and policies. Some scholars believe that the government should increase the policy support for rural commercial banks, such as providing financial subsidies and tax incentives. At the same time, we should strengthen the cooperation with other relevant departments to jointly promote the solution of the "agriculture, rural areas and farmers" problems[5].

However, the existing literature still has some shortcomings. First of all, there is a lack of specific analysis of how the new capital regulations affect the rural commercial banks and the discussion of coping strategies. With the adjustment of regulatory policies, the new capital regulations have put forward higher requirements for rural commercial banks, which need to actively adjust their business strategy, risk management and other aspects. Secondly, the existing literature on the analysis of the innovation ability and risk management level of rural commercial banks is not deep enough. Future research can further explore how rural commercial banks can improve service quality and efficiency by innovating credit products, optimizing financial services, broadening income sources and other ways. Moreover, the existing literature is not comprehensive enough on government support and cooperation mechanisms. Government support has an important impact on the development of rural commercial banks, while the cooperation mechanism helps to improve their service level and competitiveness. Therefore, the future research can further explore how the government can support the development of rural commercial banks through financial subsidies, tax incentives and other policy measures.

This paper discusses the role of rural commercial banks in serving "agriculture, rural areas and

farmers", aiming to provide useful reference and enlightenment for the academic circle and practical circles, in order to provide more beneficial ideas and methods for the sustainable development of rural commercial banks.

### 3. The main content and change of the capital new rules and regulations

The new capital regulation has constructed a set of capital supervision system in line with national conditions, and further strengthens the stability of bank operation. Centralized performance in the following points, one is to pay attention to the further localization of the rules. Second, we will match bank indicators with regulation. Thirdly, it pays attention to the sensitivity of measurement and comprehensively promotes banks to improve their risk management capabilities under the premise of risk-based supervision. Fourth, the new credit risk weight method introduces more detailed risk classification standards and procedures for exposure, and adds dynamic risk drivers to further enhance the quality and efficiency of banks in serving the real economy, and pay attention to the guarantee and guiding role of capital in banks' resource allocation. Fifth, on the premise of ensuring the sound operation of the banking system, the regulatory burden on small banks should be appropriately reduced to save regulatory resources and improve the regulatory efficiency. Sixth, banks are divided into three grades and applied to different capital supervision schemes. Seventh, the credit risk measurement mainly includes the weight method and the internal rating method have different degrees of change. Eighth, the internal rating method of measurement is more optimized. Ninth, the market risk measurement logic is optimized. Ten is that the operational risk measurement logic is optimized.

### 4. Interpretation of the impact of the new capital regulations on rural commercial banks

Today, the bank both from the overall volume or from the development of no big development, and the bank overall asset margins fell the fastest, small rural financial institutions are lower year by year (Figure 1), can say the development prospect of bank is very serious, solve some of the problems is very important.

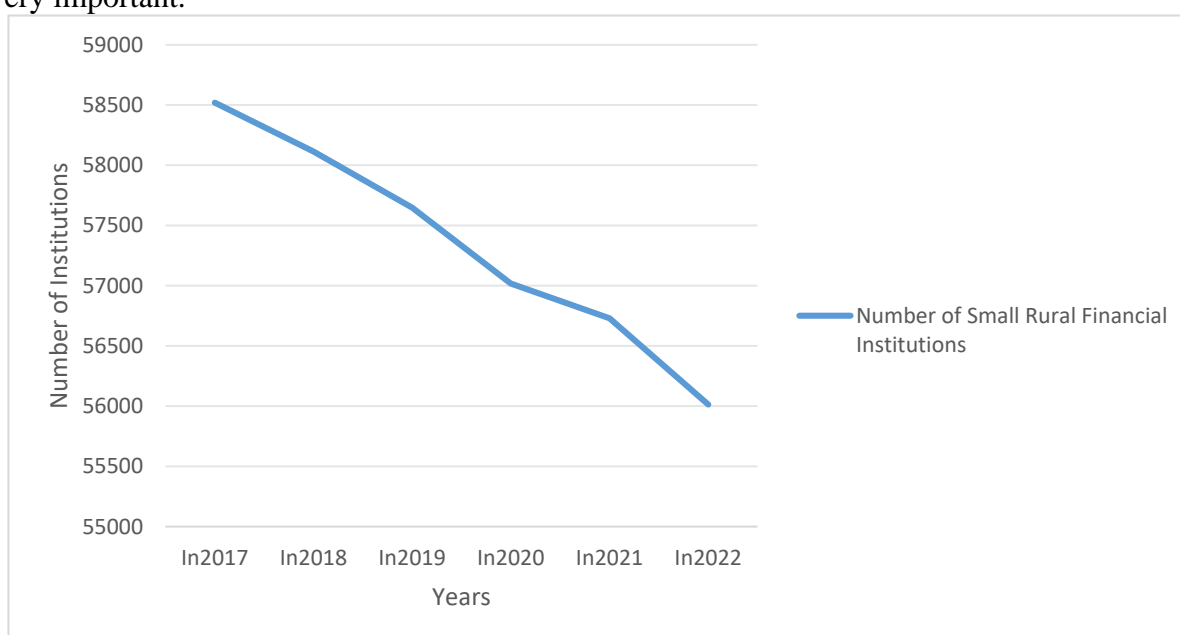


Figure 1: Number of small rural financial institutions (some provinces and cities)

With the current measures, the phenomenon of insufficient applicability of small and medium-

sized banks such as rural commercial banks is gradually emerging, facing greater compliance costs and pressure. In this regard, the new capital planning has divided into three categories of banks, and constructed a differentiated capital supervision system. At present, China's rural financial market is not mature enough, the supervision and risk control of rural commercial banks is not enough, and in the new capital rules there are many detailed rules to help rural commercial banks for risk control, here we are an in-depth interpretation of several key rules.

First, before this, RRB is still in the initial stage and exploration and trial stage in economic capital management, and the design and implementation of some index systems still need to be further improved, especially the lack of evaluation methods or technologies for internal risk differentiation of RIC system. Many domestic rural commercial banks lack of effective risk prevention and control mechanism and early warning mechanism [6]. The new capital regulations have specified the risk weights for numerous detailed items, setting different measurement rules for commercial banks of different sizes. In the Asset Risk Weight Table in Annex 23, there are clear weight indicators for large customers, small customers, and loans to both nonlocal and local customers.

These new rules further regulate the calculation of the risk-weighted assets of rural commercial banks, thus affecting their capital adequacy ratios and thus helping them control their risks.

Secondly, the new capital regulations have added the risk exposure categories of "investment-grade companies" and "small and medium-sized enterprises", applying preferential weights of 75% and 85% respectively. In the previous trial measures, this point has been changed. The "Capital Measures" will reduce the debt of qualified small and micro enterprises from 100% risk weight to 75%. When county-level rural credit cooperatives put credit assets into small and micro enterprises, they should meet the definition standards of small and micro enterprises stipulated in the "Capital Measures"[7]. Combined with further analysis of the first point, the capital rules the third commercial bank rules, the small micro enterprise risk exposure segmentation out of the large customers and small customers, set up 85% and 60% weight, which improves the large customers and foreign loan risk weight, guide the bank service county, support a small, boost rural revitalization. This change has brought a certain impact on many subjects, and played a compound role. First for those who are classified as the third bank, these Banks generally in the economy less developed rural towns, the bank assets is weak, but the local small micro enterprise capital demand, which requires the bank more fine manage large customers and small customer risk exposure, to ensure that both within the range of set weight, for different types of small micro enterprise further credit assessment and analysis, in order to carry out related business. To meet regulatory requirements, these banks need to adjust their lending strategies for large and small customers, such as adjusting loan quotas, interest rates or approval standards. In addition, the segmentation of large customers and small customers may affect the service efficiency, and banks need to develop more refined service processes to meet the needs of different customers. For small and micro businesses, financing costs may vary according to the classification of customers. Among them, farmers and other small enterprises are easier to obtain bank loans due to their low risk weight. For large customers, they may need to provide more guarantees or take other credit enhancement measures to meet their financing needs, which contributes to the precise implementation of rural support and small support. To sum up, this classification for those small volume farmers and enterprises is a good, is the current banking financial institutions pratt & whitney type small micro enterprise loans (Figure 2), bank to small micro enterprise loans is increasing year by year, believe that this method, loans will further enhance, loans help small farmers financing, help farmers out of trouble, power "three rural" work.

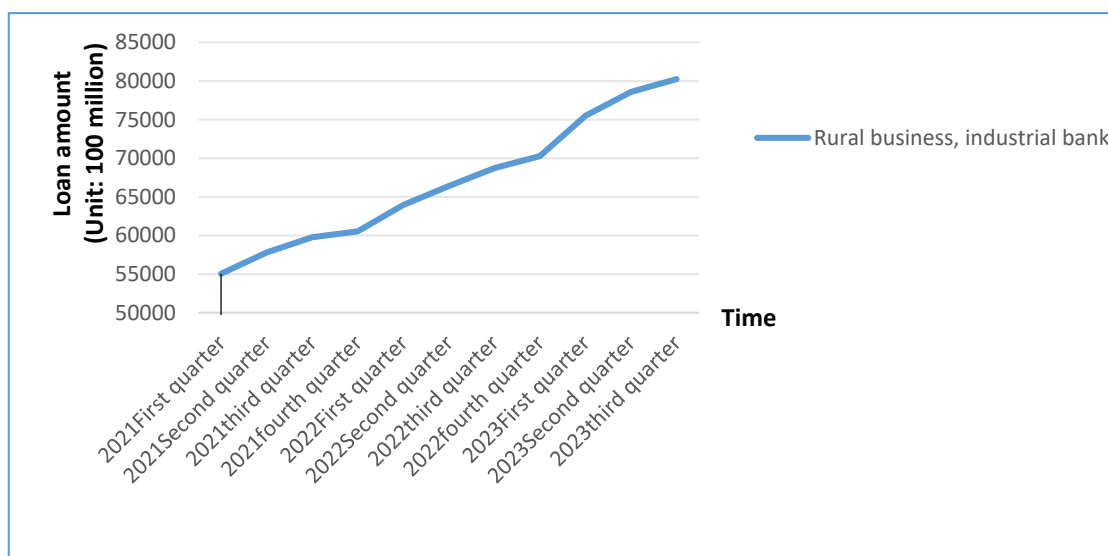


Figure 2: Loan Table of Inclusive Small and Micro Enterprises of Banking Financial Institutions (Domestic; Unit: 100 million)

Third, it is worth paying attention to the fact that the division standard between bank books and transaction books is not clear, the internal model method cannot estimate the impact of the disappearance of market liquidity, and the lack of risk sensitivity of the standard method. These problems have brought many negative effects, such as increased difficulty in risk management, and business operations blocked, financial reporting distortion and so on. These problems have been solved in the new capital rules. First, the new capital rules strictly divide bank books and transaction books, and strictly restrict the transfer between the two books, clarifying the internal risk transfer requirements and the tools to be included in bank books and transaction books. In this way, separate management can better analyze the business opportunities and market changes of different books, provide more accurate and comprehensive data for decision-making, better reflect the financial situation and operating results of different books, improve the quality and credibility of financial reports, and further improve the efficiency and effect of supervision. Secondly, the new capital regulations clarify the simplified standards and regulations, and make the corresponding multiplier adjustment on the basis of the capital requirements of the current standard law, which provides certain convenience for rural commercial banks. But the new standard method of bank data and IT system put forward higher requirements, which for some economically underdeveloped technology is a challenge, advanced measurement for risk assessment, these firms often no effective system model, for them cannot realize the algorithm, this is a problem left over by history is also need to be solved. Finally, the new capital rules further improve the access and measurement rules of the internal model method, and improve the effectiveness of the internal model method in risk assessment, which will help improve the accuracy of risk assessment of rural commercial banks, better manage risks, formulate risk control strategies and rationally allocate capital. Rural commercial banks need to strengthen the accumulation of risk data, improve the risk model, and strengthen the training of risk management personnel to improve the ability of risk identification, measurement and control, which will help rural commercial banks to establish a sound risk management system and improve the overall risk management level. To sum up, a series of new regulations are both a challenge and an opportunity for rural commercial banks, effectively solving the problems existing problems of rural commercial banks, but whether they can be fully implemented is also what we should pay attention to, which requires the efforts of the society, explore some new solutions, and jointly promote the implementation of the system.

## 5. How to better advance the work related to agriculture, rural areas and farmers

Based on rural areas and close to farmers, rural commercial banks play an important role in serving "agriculture, rural areas and farmers". Agricultural cooperatives and rural small, medium and micro-sized enterprises are the main forces in rural revitalization, but they are often frustrated in financing. Limited by low credit rating, less compliance collateral, imperfect corporate governance mechanism, relevant information is not standard and other factors, the financing availability of these enterprises is not high[7]. The implementation of the new capital regulations has put forward higher requirements for rural commercial banks to support agriculture and financial service innovation, facilitated the financing of small and micro enterprises, and made contributions to promoting the work of "agriculture, rural areas and farmers".

But there may also be some problems in the actual implementation, here we will analyze these problems. First, capital replenishment is under pressure. The new capital rules put forward higher requirements for the capital adequacy ratio of rural commercial banks, and the capital accumulation ability of rural commercial banks is relatively weak. In addition, the capital amount of some rural commercial banks is very small, the operational space is limited, and the external financing channels are relatively limited, so they face greater pressure of capital replenishment. Second, there are facing new challenges in risk management. The new capital regulations strengthen the calculation and management of risk-weighted assets, and require rural commercial banks to identify and measure risks more accurately, which puts forward higher requirements for the risk management ability of rural commercial banks. Third, the business development is limited. The implementation of the new capital regulations will limit the development of some businesses of rural commercial banks. Under the background of increasing capital adequacy ratio requirements and adjustment of risk weight, it is necessary to pay attention to reducing high-risk businesses and quickly adjust the focus of business development. Fourth, risk management is more difficult, and the new rules make a more detailed calculation of risk-weighted assets, which may increase the capital occupation and learning cost for rural commercial banks. Fifth, the challenges of exogenous capital replenishment and profit retention remain. In the case that it is difficult to cover the capital demand or the insufficient endogenous accumulation of capital, it may face some difficulties to actively implement the supplementary exogenous capital and improve the overall capital strength. Sixth, the lack of talent reserve and retention is insufficient. The implementation of the new capital regulations requires the rural commercial banks to have the corresponding talent reserve. However, because the rural commercial banks are located in rural areas, it is difficult to introduce and retain talents, and the lack of talent reserve has become one of the difficulties in the implementation of the new capital regulations.

In order to solve these problems, we put forward the following countermeasures from the perspective of rural commercial banks, hoping to be helpful to them. Firstly, rural commercial banks should optimize their asset structure, strengthen capital management, and improve capital adequacy ratios to meet regulatory requirements, and reduce risk-weighted assets to control capital adequacy ratios effectively from the denominator perspective. Secondly, rural commercial banks should enhance their risk management capabilities, strengthen risk assessment and management, improve risk assessment and management systems, introduce advanced risk management technologies, and establish risk databases to help improve their risk management levels. Thirdly, rural commercial banks should expand financing channels, actively improve their overall capital strength, and implement supplementary exogenous capital when endogenous capital accumulation is insufficient or difficult to cover capital needs, such as raising capital through bond issuance. Fourthly, rural commercial banks should formulate reasonable profit distribution plans based on business development plans and capital conditions, ensure a certain amount of retained profits, and optimize profit distribution. Fifthly, rural commercial banks should promote business innovation and



transformation and upgrading, strengthen the application and innovation of financial technology, develop emerging businesses such as low-risk businesses and intermediary businesses, optimize business structures, and reduce reliance on traditional high-risk businesses. Sixthly, rural commercial banks should strengthen internal management, improve internal system construction and process optimization, establish a sound internal control system, prevent moral risks and operational risks, and improve management efficiency and execution. Seventh, in view of the particularity of "agriculture, rural areas and farmers" economy, rural commercial banks should deeply study the development trend and risk characteristics of agricultural economy. On this basis, combined with the requirements of the new capital regulations, the business model and development strategy in line with the economic characteristics of "agriculture, rural areas and farmers" are formulated. For example, according to the seasonal characteristics of agricultural production, arrange the amount and time of loans reasonably, and establish corresponding risk transfer and dispersion mechanism for the unpredictability of agricultural risks. Eighth, pay attention to the training and retention of financial talents, and actively carry out the training work and special study. At present, some attempts have been made. For example, the financial management major of Beijing Vocational College of Agriculture began to recruit the first high-quality rural financial management farmers class in 2020, and so far it has enrolled more than 400 students from 10 classes in four sessions [8]. However, from the perspective of the number of employees in small rural financial institutions in recent years (Figure 3), the situation of rural economic talents is not optimistic. There is a great downward trend in the epidemic. However, with the epidemic and the economic recovery, the number of employees has increased to a certain extent. On this basis, rural commercial banks should further carry out more special training, timely organize professionals to learn new methods and new regulations, and implement the central rules and regulations, while further formulate and improve the relevant methods and incentive mechanisms. The local government should also introduce relevant incentive policies to eliminate worries for talents and improve welfare benefits. After all, only people can develop. Only by retaining talents can we implement the work of "agriculture, rural areas and farmers" faster and better.

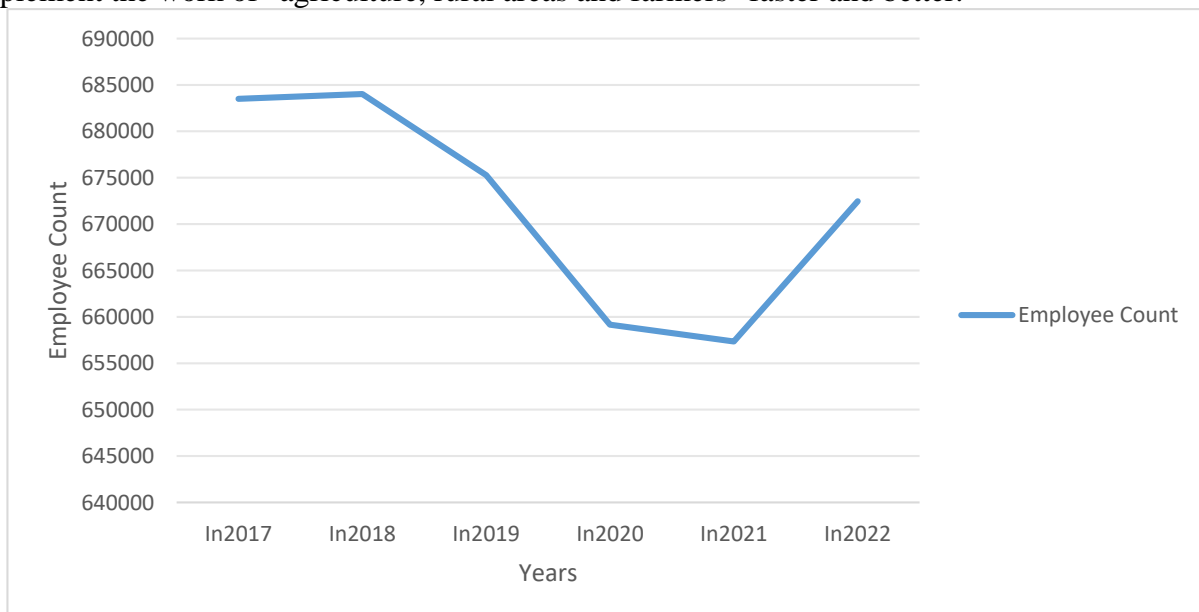


Figure 3: Total number of employees of small rural financial institutions (some provinces and cities)

## 6. Conclusion and Outlook

At present, the research on how to better serve the "rural agriculture and rural farmers" economy under the new capital regulations has made some achievements, but this article is subject to the cognitive limitations in the research process, and there are still some shortcomings. First of all, the research perspective is not diversified enough. At present, the existing research mainly focuses on the impact of the new capital regulations on rural commercial banks and the coping strategies of rural commercial banks. The in-depth research on how to implement the reform and how to more effectively serve the "agriculture, rural areas and farmers" economy is still not specific and comprehensive enough. In addition, this paper only provides a general idea and direction for how to better develop rural commercial banks, but lack of empirical research and practical test. Although many scholars have put forward various suggestions and strategies, the effectiveness of these strategies has not been sufficiently empirically tested. Although some scholars have mentioned the experience of successful foreign banks, how to apply these experiences to the actual situation in China still needs further discussion and further study. Therefore, the future research needs to constantly strengthen attention, further follow up the development of rural commercial banks, in order to better promote rural commercial banks, better serve the "agriculture, rural areas and farmers" economy.

The party's 20th Congress has made new arrangements for comprehensively promoting rural revitalization, promoted the modernization of rural agriculture, provided a good foundation for the work of "agriculture, rural areas and farmers" in the current era, and laid a solid foundation for the future rural development. With the increasing national attention and support to the work of "agriculture, rural areas and farmers", in the future, the rural business bank will further deepen the service of "agriculture, rural areas and farmers", increase the supply of financial services for agriculture, rural areas and farmers, and meet the growing financial demand of "agriculture, rural areas and farmers". In the future, RCB will pay more attention to the application and innovation of science and technology, and use scientific and technological means to improve the quality and efficiency of financial services. For example, through mobile payment, online banking, artificial intelligence and other technological means, to improve the coverage and convenience of financial services in rural areas. Under the concept of sustainable development, RCB will pay more attention to the development of green finance, increase support for environmental protection, energy conservation, clean energy and other fields, and promote the construction of ecological civilization in rural areas and the green development of agriculture. It will further promote the development of inclusive finance, provide more diversified and convenient financial services for low-income groups and poor people in rural areas, and contribute to poverty alleviation and inclusive development in rural areas. With the increase of agricultural risks, agbanks will actively explore agricultural insurance business, provide more risk protection services for farmers, and help them reduce the risk of agricultural production. In the context of globalization, RCB will strengthen cooperation with other countries or regions, introduce international advanced financial concepts and technologies, improve their international competitiveness, and provide a broader vision and resources for the work of "agriculture, rural areas and farmers".

With the increasing national attention to and support for rural finance, we have reason to believe that under the guidance of national policies, rural commercial banks will be able to further improve the level of rural finance and make greater contributions to the construction of a new rural economic system. The implementation of the new capital regulations has brought new challenges and new opportunities to the economic work of rural areas and rural areas. It is believed that under the background of the implementation of the new capital regulations and the new economic environment, rural commercial banks can provide better financial services, further promote the rural revitalization strategy, and make the rural development flourish.



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