

A Brief Discussion on the Current Situation and Countermeasures of Non-Performing Loans of Commercial Banks in China

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ABSTRACT. The problem on non-performing assets of commercial banks is the focus of our country. By analyzing the current situation of non-performing loans in recent years, this paper summarizes that non-performing loans of commercial banks are comprehensively influenced by internal management and risk prevention ability, external borrower credit as well as government intervention and legal system. In order to effectively deal with non-performing assets, this paper puts forward three countermeasure proposals: establishing full-process risk management, building long-term cooperation with trusted customers and fully utilizing social resources, hoping to provide help for commercial banks to reduce non-performing loans.

KEYWORDS: Commercial banks, Non-performing loans, Government intervention, Risk prevention

1. Introduction

The main function of commercial banks is to provide loans and make economic adjustments. Commercial banks have a stable operation and development, which is very important to China's financial market and an important guarantee to safeguard people's livelihood. According to the borrowers' repayment ability, the bank divides the loan into five levels: normal, concerned, secondary, suspicious and lost. Non-performing loans refer to sub-prime, suspicious and lost loans, representing greater credit risks. If effective measures are not taken in time, the bank will likely lose money and be unable to collect funds. At present, China's economy is under great downward pressure. With the deepening of supply-side structural reform, the total amount of non-performing loans of commercial banks continues to rise. According to data publicly released by the China Banking Regulatory Commission, the non-performing loan rate of commercial banks at the end of 2019 was 1.86%, and the non-performing loans were 2.41 trillion yuan, an increase of 38 million yuan over the end of the previous year. The continuous rise of non-performing loan rate not only affects the banks' own development, but also has a great impact on the financial market. We must attach great importance to the problem that the non-performing loan rate of banks is rising again.

2. Analysis of Non-Performing Loans of Commercial Banks

2.1 The Total Amount of Non-Performing Loans Continues to Increase

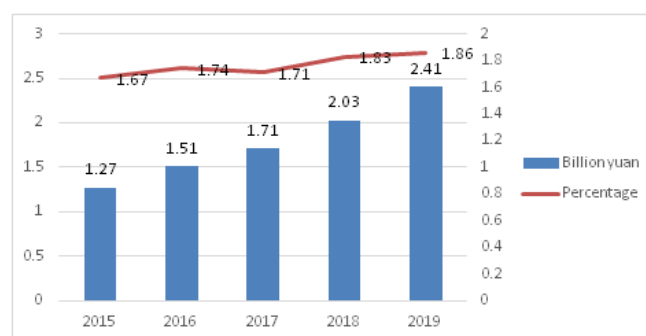


Fig.1 Non-Performing Loan Scale and Non-Performing Loan Rate of Commercial Banks in China from 2015 to 2019

According to statistics, compared with 2015, the amount of non-performing loans of Chinese commercial banks has soared from 1.27 trillion yuan to 2.41 trillion yuan in 2019, an increase of 89.8% in five years, and the non-performing loan ratio has also climbed to 1.86% from 1.67% in 2015. The continuous growth of non-performing loans and the increasing pressure on the banking industry will seriously affect China's economic growth.

2.2 Non-Performing Loans Are Unevenly Distributed

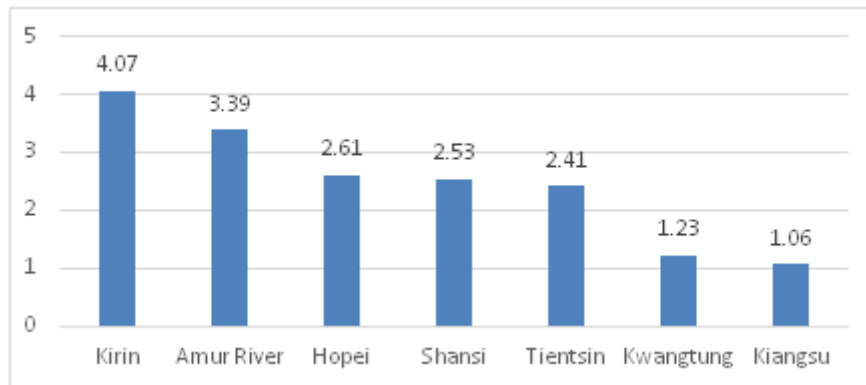


Fig.2 Non-Performing Loan Rate of Banks in Different Regions At the End of September 2019

Under the pressure of regional economic changes, the non-performing loan ratio of the banking industry shows certain regional distribution characteristics. At the end of September 2019, the non-performing loan ratios in heavy industrial areas such as Amur River and Kirin, represented by northeast China, were 3.39% and 4.07% respectively, making structural adjustment difficult, exposing more risk points and having lower risk resistance. The quality of banking assets in Kiangsu, Yangtze River Delta and other southeast coastal areas is generally good and the non-performing loan ratio is low.

This is a phenomenon caused by the imbalance of credit delivery structure of commercial banks in China. Kwangtung, Shanghai and other regions enjoy good economic development and low credit risk, thus attracting more bank investment. In the long run, the accumulation of funds in economically developed areas has prevented local enterprises from receiving subsidies and thus from developing healthily. Finally, the quality of bank credit assets is getting lower and lower

2.3 It is Difficult to Collect Non-Performing Loans

The collection of non-performing loans refers to the net recovery of the principal and interest of non-performing loans with monetary funds. There are four difficulties in the collection. First, it is difficult to identify debts. Second, it is difficult for the borrower to contact. Next, it is difficult in collecting non-performing loans due to government intervention. Then, Non-performing loans resulting from poor management and inability to repay the loans, as well as the escape of the borrowers, are also difficult to collect.

2.4 Lack of Effective Financial Supervision Institutions

At present, China's financial market lacks effective regulatory agencies. Moreover, the existing financial supervision institutions are only standardized supervision and basically do not carry out risk management. At the same time, financial regulatory agencies are monitoring more whether commercial banks operate legally and in compliance, and do not conduct in-depth investigations on whether banks operate effectively. The main way of supervision also stays in the on-site inspection. This "formalized" external supervision makes the internal management of banks unable to be effectively supervised and lacks effectiveness and precaution.

3. Analysis on the Influencing Factors of Non-Performing Loans of Commercial Banks in China

Non-performing loans of commercial banks are formed by various reasons. Affected by various factors, they can be roughly divided into four categories: bank management and risk prevention capability, borrower's credit awareness, government intervention and laws and regulations. The specific analysis is as follows.

3.1 The Bank's Management and Risk Prevention Capabilities Are Relatively Low

The main reason for non-performing loans of commercial banks is the banks' low level of management and risk prevention. The extensive management of banks needs to be revised urgently. The bank's higher performance appraisal system makes the operation more short-term. Commercial banks lack an effective risk early warning system and lax supervision of loan procedures, resulting in insufficient prior regulation. However, for the loans issued, the bank managers did not carry out continuous post-loan evaluation and could not timely understand the real situation of the operation and management of the loan enterprises, which greatly increased the risk of non-performing loans.

3.2 The Borrower's Credit Awareness is Weak

Borrower's credit consciousness is not strong, evading repayment is the objective reason for commercial banks to produce non-performing loans. The customer's credit awareness is weak, and with the mentality of “delaying if you can, and not returning if you can”. Although it has the ability to repay, it is unwilling to repay and does not take the initiative to repay, which has had a serious impact on the bank's asset quality and economic benefits. However, some customers, in order to obtain the qualification to apply for loans, make up false information and do everything they can, plus bank managers are not careful enough in handling lending requirements in order to meet performance standards, which will increase the risk of non-performing loans.

3.3 Government Intervention in Credit Delivery

Party and government departments and financial departments interfere with commercial banks to put in loans, resulting in the financialization of credit funds, which is the external factor that produces non-performing loans. In recent years, China's Ministry of Finance has requested to strengthen the financing of small and micro enterprises. However, small and micro enterprises are not strong in profitability, credit rating and risk resistance, and cannot meet the lending requirements of financial institutions. However, in order to respond to the national call and further support the supply-side structural reform, commercial banks have invested a large amount of funds in key areas and weak links of the national economy. The government chose to ignore the willingness of commercial banks to lend and commercial banks had to comply. Banks lend money to enterprises, and enterprises determine their use. If the decision-makers make mistakes and the investment projects fail to achieve the desired results, the loans will be unable to repay when they are due and non-performing loans have been formed for a long time. Under this model, the bank is the lender, the government and the Planning Commission are responsible for project approval and approval respectively, and the finance and the bank pay the bill.

3.4 Laws and Regulations Are Not Perfect

China's laws and regulations are not perfect enough, the creditor's rights and debts between banks and enterprises are not clear enough, and the regulatory agencies cannot fully play their role. The financial market changes rapidly, and the credit management level of our commercial banks is relatively backward, so it is difficult to learn from the international financial system. Not only that, the law enforcement departments in our country are lax in enforcing the law, and local protectionism makes the relevant regional law enforcement departments unable to enforce the law fairly.

4. Countermeasures and Suggestions on Disposal of Non-Performing Loans of Commercial Banks

In order to effectively deal with non-performing loans of commercial banks, this paper will trace the source of non-performing loans and make corresponding disposal suggestions according to the causes of non-performing loans.

4.1 Establish Whole Process Risk Management and Establish and Perfect Internal Control Mechanism

4.1.1 Double Combination of Financial and Non-Financial Information, and Comprehensive Pre-Loan Prevention

As the saying goes, “seven points for customers lie in selection and three points lie in management”. Credit risk management starts with customer selection. Before lending, banks have the initiative to decide whether to lend or not. After the loan is established, the borrower will decide whether to repay the loan. For loan applicants, bank managers should fully combine financial and non-financial information to carry out comprehensive pre-loan prevention. Bank managers should ensure that the “5C” index of loan applicants meets the criteria for applying for loans. They cannot simply pursue the amount of loans in order to meet the performance criteria. They should make careful decisions on

every lending behavior. At the same time, the bank can sign a mortgage loan with the loan applicant in advance. In case of default, the bank will sell the signed mortgage to make up for as much loss as possible. The bank can also request compensation balance according to the borrower's credit risk.

4.1.2 Post-Loan Continuous Monitoring

The continuous monitoring after the loan is very important. Some customers received loan funds but used them elsewhere, resulting in frequent occurrences of banks failing to collect loans when due. In order to prevent these credit risks, banks need to track and monitor the use of funds by loan applicants. Bank managers should keep close contact with customers to remind them to repay on time. When a customer fails to repay on time, the bank should increase communication with the customer, understand the basic situation of the customer, try to correct the customer's lackadaisical mood, not exert too much pressure, and strive to achieve mutual coordination. Bank personnel must not be unprincipled. Auction of pledged goods and recourse from guarantors are effective measures for banks to reduce losses.

4.1.3 Reasonable Disposal of Non-Performing Loans in Late Stage

Banks dispose of non-performing loans in a variety of ways, generally including bad debt write-off, independent collection, debt restructuring, and transfer of non-performing assets. General commercial banks use write-off of bad debts as the main means. In recent years, some commercial banks have chosen to transfer non-performing assets to financial asset management companies (AMC). this kind of "transfer of non-performing assets", i.e. "package sale", can reduce the non-performing loan rate of banks relatively quickly and achieve a higher recovery rate. it is another good choice to dispose of non-performing loans. In 2016, China's market will restart securitization of non-performing loans. Securitization of non-performing assets and debt-to-equity swap will become new measures to dispose of non-performing assets.

4.2 Establish Long-Term Cooperation with Trusted Customers

People do not stand without faith, and businesses do not prosper without faith. Honesty, which virtually increases the value of an enterprise, is an intangible asset of an enterprise. The construction of honesty culture is very important for enterprises. When issuing loans, banks should establish long-term cooperation with trusted customers. On the one hand, banks can know their assets and capital flow status according to the customer's account, on the other hand, they can also know their solvency and credit according to their past repayment status, thus reducing credit risks.

4.3 Using Social Resources to Dispose of Non-Performing Loans

The initial aim of setting up a financial asset management company is to help state-owned banks preserve assets and reduce losses. Asset companies use foreign capital to dispose of non-performing loans, including: reorganizing and disposing the assets they own through absorbing foreign capital, selling directly, securitization of assets, etc. In addition, state-owned commercial banks can raise funds through listing to clean up non-performing loans. Furthermore, the role of local government can be brought into play, and by improving policies and regulations, the trading environment for non-performing investments can be improved, thus virtually helping banks to reduce non-performing loans.

5. Conclusion

In recent years, China's macro-economic growth rate has continued to decline, while non-performing loans of commercial banks have maintained an inertial growth rate. In addition, strict financial supervision has continued to push forward, and the asset quality of commercial banks has moved forward under pressure. In 2018, the requirements of the CIRC are to include loans overdue for more than 90 days into the non-performing loan statistics, so as to require commercial banks to truly reflect the asset quality. Obviously, it is urgent to reduce the non-performing loans of commercial banks. This paper analyzes the current situation and influencing factors of non-performing loans in commercial banks, and proposes that commercial banks should establish full-process risk management to improve their risk prevention ability, including pre-loan prevention combined with financial and non-financial information, continuous post-loan supervision and timely measures to deal with non-performing loans in the later period. They should establish long-term cooperation with trusted customers to reduce credit risks, and use social resources to rationally dispose of non-performing assets, hoping to provide help for commercial banks in China to reduce non-performing loan rate.

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