

# Analysis on Risk and Prevention for Rural Banks\*

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**Abstract**—The development of rural banks in China is in its initial stage, whose risk prevention capability is relatively poor, banking business is relatively simple, and funding channels are not broad enough. This has limited the development of rural banks to a certain extent, and restricted the sustainable development of rural banks. This paper conducts research on the risk issues of rural banks, aiming to show the causes of risks and explore the basic path for risk management and precautions.

**Keywords**—rural bank; risk management; preventive measures; self-construction

## I. INTRODUCTION

In order to implement the requirements of the Party Central Committee and the State Council, deepen the reform of financial system in rural areas, enrich the rural financial organization system, improve rural financial services, and solve the problems of low coverage of financial institutions, insufficient financial supply and insufficient competition in rural areas, in December 2006, the China Banking Regulatory Commission promulgated Several Opinions on Adjusting and Relaxing the Access Policy for Banking Financial Institutions in Rural Areas to Better Support the Construction of a New Socialist Countryside.

In March 2007, the first compliant rural bank was established in Sichuan. After ten years of development, the number of rural bank institutions has reached 1,519, with an asset scale exceeding one trillion, reaching 1,237.7 billion yuan<sup>1</sup>. Rural banks have played an important role in activating rural financial markets, improving the rural financial system, developing inclusive finance and supporting rural economic development. In recent years, the development of rural banks has made great achievements, with great development prospects and space. However, as a new thing, the development time of rural banks is short, the development is not perfect, the risk management issues are outstanding, and risk management and prevention have become the common topics faced by the development of rural banks.

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<sup>1</sup> China Banking Regulatory Commission. The Major Data Bulletin for the Ten-year Development of Rural Banks [DBOL].

## II. OVERVIEW OF RURAL BANKS

Rural banks refer to the banking financial institutions that are approved in accordance with relevant laws and regulations of the China Banking Regulatory Commission, funded by domestic and foreign financial institutions, domestic non-financial institutions, and domestic natural persons, and established in rural areas, mainly to provide financial services for the economic development of local farmers, agriculture and rural areas. Rural banks are different from previous bank branches, and they belong to first-level legal person institutions. The term “rural” mainly plans its service areas and objects. The particularity and special meaning of rural banks have made them an indispensable part of China's rural financial system, and the special support of policies also provides a good environment for the sustainable development of rural banks. Rural banks have added new elements to the development of China's banking industry, increased the vitality of the market and provided impetus for the development of the banking industry. They invisibly put pressure on other state-owned banks and form industry competitiveness; at the same time, they make the industrial restructuring more flexible in the entire banking system.

## III. RISK ANALYSIS OF RURAL BANKS

### A. Management Decision Risk

It mainly refers the risk at the management level, including the risks that may arise from the issuance of the policy documents by CBRC, central bank, government, bank and decisions made by management personnel with decision-making capabilities. China Banking Regulatory Commission and the central bank mainly provide macro directions and conduct supervision and management to let rural banks will develop in a good and correct direction. The support of local governments will increase the trust of depositors in rural banks and improve the credit rating of rural banks; the government's support for local enterprises or closeness to “agriculture, rural areas and farmers” will make local enterprises more energetic, including the promotion and support of “mass entrepreneurship and innovation” that make more people willing to start businesses, making the rural bank loans get resources, having an important impact on the sustainable development of the banks. For the self-management of rural banks, first of all, it is necessary to ensure that their own development policy and foothold meet the regulations of the China Banking Regulatory Commission

and the central bank, and more specifically refine their own functions in the framework they set, dare to innovate, and better serve the "agriculture, rural areas and farmers". Decision makers must grasp the political direction and set the bank's own positioning, because in terms of functions, rural banks are different from other state-owned banks (such as BOC, ABC, ICBC, and CCB). A decision or a message from the decision makers may cause the rural banks to collapse instantly. The rural banks are still very weak at present, and cannot withstand risks. Most farmers have a cognitive bias against the rural banks, and think that the rural banks are private banks, so they dare not put money in the rural banks. In the past, there were many precedents that some organizations that raised funds in rural areas fled with money overnight and could not be found. Therefore, the people are more convinced of the big banks and still have a certain wait-and-see attitude and suspicion for the rural banks. Rural banks cannot handle deposit and loan business across regions, but can only absorb local funds and have strict geographical restrictions, which frustrates the development of rural banks and brings management decision risks.

### *B. Credit Risk*

Credit risk, so to speak, is a common problem of various banks, and an inevitable risk for any bank. It is the main type of financial risk, mainly reflected in the risk caused by the inconsistency of loan customers' acts before and after and uncontrollable factors. Customers may even have a huge risk and reverse selection risk, which is caused by asymmetric information. The credit risk of rural banks mainly refers to the risk for losses of the banks caused by the failure of the borrowers to repay the principal and interest within the specified time.

The causes of credit risk are broadly divided into policy risks, regional economies, and personal limitations. Rural banks support rural areas and small & medium enterprises, serve farmers and agricultural areas, and therefore the local lending policies have a major impact on banks. If policies are relaxed or improperly formulated, it will amplify the unknown risks and create hidden dangers. The development strength of the local economy is also extremely important. Without development prospect, the basic economy is weak, both the borrowers and lenders lack confidence, resulting in mutual distrust, which is not conducive to lending, and there is a great credit risk. Personal limitations are reflected in the fact that the loan target is mainly low-income residents, vulnerable groups and industries of small and micro enterprises, which make the credit risk of rural banks have certain particularity. Small loan objects tend to have poor credit awareness, do not value credit, and even abuse their credit.

### *C. Risk of Runs*

A run refers to the situation in which a large number of depositors withdraw cash from the banks at the same time due to panic in the collapse of financial institutions or financial crisis. Generally speaking, the deposit reserve of banks is not enough to pay for the run in a short period of time. The prevention for risk of runs is also common among rural banks. To a large extent, rural depositors believe that commercial

banks or rural banks are not state-owned and private. Once there is a sign of disturbance or trouble, it spreads quickly, resulting in crazy runs, so there is a liquidity risk<sup>2</sup>. A famous case is the centralized payment event of Jiangsu Sheyang Rural Commercial Bank. Because of a rumor, the depositors concentrated on the run, and the bank had to promptly mobilize funds and help the depositors withdraw money all night to calm the crisis.

### *D. Risk of Counter Operation*

The risk of counter operation generally refers to the risk of direct or indirect loss caused by the rural banks' own internal procedures, personnel, operational technology information systems and external events. The risk of counter operation is an endogenous risk that can be controlled, but the risk of counter operation of rural banks is more prominent than that of other financial institutions. The risk of counter operation is mainly from the tellers. The rural banks have just started, part of whose personnel are professional financial personnel assigned by the state-owned holdings, while the other part is the graduates or related personnel who have no job experience. The inconsistent cultural level, different quality and low overall level of counter operators may cause risks.

On the one hand, cash counter operators are prone to emotional control or temporary irrationality, which result in incredible acts, causing instability risks. For example, they may operate illegally due to gambling debts, urgent need for money, etc., resulting in losses to banks. The above are subjective behaviors, and there are also objective behaviors, for example, due to the impact of the external environment, the amount of deposits and withdrawals and the amount of transfer is wrong, even if it can be recovered, it will result in a certain loss; the operating system problems may cause failure to correctly handle the business, and need technical support, which are all potential risks of counter operation. On the other hand, loan officers may act out of "human feelings" for various reasons. For example, when the materials are not complete, they may issue the loan first and then supplement the data, and such operations are also very risky. Such situation is very likely to happen, and there may even be rebates, making the bank funds suffer a huge risk.

## IV. SUGGESTIONS ON THE RURAL BANKS' RISK PREVENTION MEASURES

In general, the problems arising from the rural banks are mainly in the process of development, in which the market positioning has deviated from the government's objectives and farmer crowd, and it is not pragmatic. At the beginning of the establishment, the rural banks have more policies to absorb funds, and the number of early loans was relatively small; in the medium term, the deposits became stable, and the number of loans gradually increased, and there was even a phenomenon of insufficient deposits, with a high deposit / loan ratio; rural banks are relatively weak in marketing, their business strategy is relatively simple, their risk control and

<sup>2</sup> Liquidity risk refers to the risk that financial institutions cannot provide financing for increase in assets or reduction in liabilities, resulting in loss or bankruptcy.

rules and regulations are not fully mature, and their profitability is not stable.

#### A. Risk Prevention for Management Decision

In order to manage decision-making risks, it is necessary to optimize the external environment of rural banks, and rural banks have to do well in their own risk control and prevention. The CBRC, the central bank and the government also have the responsibility and obligation to improve the business development environment of rural banks, and fully play a role in supporting, guidance and supervision, to jointly make the rural banks in our country develop healthily and sustainably, and reduce the level of financial risks. The rural banks are born for "agriculture, rural areas, and rural residents", and they can only get more development based on the market of rural finance. The new rural areas are constantly being built, and the country is devoted to targeted poverty alleviation. The rural banks can seize this opportunity to improve and develop themselves, and conduct innovation and reform.

#### B. Credit Risk Prevention

In terms of credit risks, banks need to establish a credit rating system and personal credit file. For example, the enterprises can be divided into six grades: D, C, B, BB, A, and AA. Different grades of customers have different amounts of loans, and the lending is strictly controlled. The rating is a comprehensive assessment performed by the loan officer after accompanying the supervisor to inspect the strength of the company, which reduces risks to some extent. It is necessary to establish personal credit files for rural populations, publicize the importance of personal credit, improve their financial knowledge, and reduce risks. For possible arrears or unrepayable loans, it is necessary to follow up on the situation in timely and get a solution as soon as possible to prevent problems before they happen.

#### C. Prevention for Risk of Runs

For the risk of runs on the bank, in addition to publicizing the nature of the rural banks, the best way for the people to take the reassurance is the adequacy of capital. If the rural banks operate stably and can cope with the risk of bad debt loss, the possibility of liquidity explosion will be greatly reduced (even if there is a run, people can pull through safely). The supervision and management departments need to formulate policies, steadily push forward the reform of financial marketization, let the public re-establish confidence in the banks, increase the publicity of the deposit insurance system, strengthen public opinion guidance to the public, and build multi-level financial safety net at the institutional level; in order to cope with the unexpected situations, it is necessary to establish a relevant supervision and management system; at the same time, the banking industry should also establish correct values. The banking industry belongs to the service industry and must focus on customers. At present, many large banks are not clearly aware of this; luckily, the rural banks have paid more attention and efforts in this regard.

#### D. Prevention for Counter Risk

For the risk of counter operation, it is necessary to improve the overall quality of the employees in the rural banks, and build a high-quality staff and senior executive team, which is an important guarantee for the sustainable development of the rural banks. Banks need to adhere to the correct orientation of employing people, and train professionals with political qualities, leadership skills, and familiarity with business as senior executives, to correctly lead their subordinates to prevent risks. For existing practitioners, it is necessary to strengthen the training of professional skills, continuously learn new knowledge, acquire new knowledge, strengthen humanistic care, cultivate professional ethics and sense of responsibility, strengthen risk awareness, and build a team of employees capable of taking on great responsibilities.

### V. CONCLUSION

The demands for rural finance are diversified, and rural banks have good prospects for development in rural areas by virtue of geographical advantages. However, rural banks must upgrade their core competitiveness, improve their credibility, find a correct position, open up markets, and innovate deposit and credit service products that are in line with rural finance. Although the future roads of rural banks will have many difficulties and obstacles, in the era of supporting rural finance, rural banks and rural areas are closely linked, and their development prospects are immeasurable.

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