Preventing financial risks and promoting high-quality development of China's financial business

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Abstract: Preventing and resolving the financial risks is the focus in the current and future financial work. Controlling the systemic financial risks not only lays the foundation but also the key to promoting the high-quality financial development. This article is guided by the National Financial Work Conference, this paper concentrates on adhering to the eternal theme of preventing and controlling financial risks in finance, with a focus on the comprehensive strengthening supervision, preventing and resolving the risks, adhering to the theme of making progress while maintaining stability, coordinating the development and security, firmly guarding the bottom line of preventing systemic financial risks, following the path to the financial development with Chinese characteristics, and accelerating the construction of a modern financial system with Chinese characteristics.

Keywords: Financial regulation; Financial risk; Financial system

1. Introduction

Currently, with the comprehensive operation of the financial industry developing deeply, the financial risks are becoming more covert, complex and contagious. Therefore, it is of great importance to strengthen the financial supervision comprehensively. The National Financial Work Conference stressed on comprehensively strengthening the financial supervision and effectively prevent and resolve the financial risks. It shall improve the effectiveness of financial supervision, bring all financial activities under supervision in accordance with the law, comprehensively strengthen the institutional supervision, behavioral supervision, functional supervision, penetrative supervision and continuous supervision, eliminate the gaps and blind areas in supervision, strictly enforce the law, dare to show the blade, and crack down on illegal financial activities. The year of 2023 acts as a milestone in the history of the financial industry regulation in China[1]. In 2023, the trend of strong and strict supervision continues, and the "Iron Fence" of the supervision system is tightened. The comprehensive strengthening of financial supervision provided a strong guarantee for preventing and resolving financial risks and serving the high-quality development of the real economy. It indicates accelerating the formation of a new pattern of financial regulation, and a significant reform of the financial supervision in China will take place in 2023. In March 2023, the CPC Central Committee and the State Council issued the Plan for the Reform of Party and State Institutions, many of which involve the financial supervision: the establishment of the Central Financial Commission, the establishment of the Central Financial Work Committee, the establishment of the China Banking and Insurance Regulatory Commission, the further reform of local financial supervision system, the adjustment of the China Securities Regulatory Commission to a directly affiliated institution of the State Council, and the coordinated promotion of the reform of the branches of the People's Bank of China. The intensity of reform has been the greatest in recent years. Then, the promotion of the relevant reforms is as follows: on May 18, 2023, the China Banking and Insurance Regulatory Commission was officially established; On July 20, 2023, 31 branches of the People's Bank of China (PBC) in provinces (autonomous regions and municipalities directly under the central Government), 5 branches in separately planned cities and 317 regional (cities) branches were officially established. On November 10, 2023, it introduced the plans "Three Definite" of the National Financial Regulatory Administration and the China Securities Regulatory Commission, respectively.

2. Three Important Principles for Preventing and Resolving Major Risks

To prevent and resolve the financial risks, it shall keep a good balance in the relationship between
rights and responsibilities, and establish a responsibility mechanism for handling the risks, which is consistent with rights and responsibilities and compatible with incentives and constraints. It shall keep a balance between speed and stability, utilize the time and effectiveness with the stable situation, resolve the risks solidly and prudently, punish the illegal corruption resolutely, and strictly guard against moral risks; To identify, warn, expose and deal with the risks earlier, it shall establish a sound early correction mechanism for financial risks with hard constraints.

2.1 Adhere to preparing for worst-case scenarios and being vigilant in peace time.

Only by adhering to preparing for worst-case scenarios, enhancing the awareness of potential risks and focusing on preventing and resolving the major risks, can we calmly deal with the financial risks and challenges, maintain the sustainable and healthy development of economy and keep the stability of the whole society. In January 2019, in the opening speech of the special seminar on prevention and resolution of major risks, put forward that "it shall have further understanding and accurately figure out the great changes in the external environment and the new situations, problem and challenges in the stability of the reforms in China. And it shall also adhere to preparing for worst-case scenarios, enhance the awareness of risks, improve the prevention and control capabilities, focus on preventing and resolving the major risks, and maintain the sustainable and healthy economic development and social stability." Served as a scientific thinking method and effective working method, preparing for worst-case scenarios should be applied to practice, start from the worst part, and make the best estimate on the difficulties and challenges that may arise.

2.2 Make preparations and take preventive measures

Predicting risks is the basis for preventing risks, and judging the trend of risks is the key to looking for the strategic initiative. Attention should be paid to strengthening the prevention and resolution of major risks in the crucial fields. For the different potential risks and their causes, it is necessary to have an understanding, take proper measures and carry out with different policies, which will effectively enhance the ability to deal with and resolve the risks. The perfect situation for preventing major risks is to prevent and control them in advance. Strengthening pre-assessment and management will help to prevent the risks before they occur, and try to make detection and prevention earlier. Without preparing for worst-case scenarios, there will be no prediction, and without prediction, there will be no prevention. Attention should be paid to the type of risk, the location of occurrence, the causes and the trend, when predicting the risks. It shall prepare the plan carefully, with a good understanding and good measures. When preventing the risks, it shall focus on the key points, make out the steps with objectives, comprehensively take the single risks, derivative risks, related risks and their associated indicators into account, and emphasize on monitoring the early warning of the risks and potential transmission channels that may be possible to cause other risks.

2.3 Seize the key points and turn risk into opportunity

"Generally, risks come along with opportunities. The opportunity will come when overcoming the risk." Transforming risk into opportunity is not only dialectical materialism, but also the wisdom of the survival, development, and rejuvenation of the Chinese nation. We shall improve our ability of resolving the risks, find out the essence through complex phenomena, grasp the key points, identify the causes, make decisions, be good at guiding and organizing the masses, integrate different forces, make reasonable arrangement and deal with them effectively. [2] We shall think out of the box to take the risks into account. Different risks do not arise separately, but are likely to be involved with each other and form a risk complex, with special attention paid to high risks, strong correlation and strong hidden risks. As risks come along with opportunities, it shall capture and create the opportunities from the current crises and difficulties. It shall make full use of advantages, avoid any disadvantage, follow the mass line, gather consensus and strength and turn the risks into opportunities.

Over a period of time, the deviation in the execution intensity and pace of resolving the financial risks have resulted in some new risks. The National Financial Work Conference took the problems arisen in past seriously, constructed a theoretical framework and practical path to the process of dealing with the risks based on the rights and responsibilities and incentive constraints, which consists of "early warning in advance - dealing with the risks fast and stably in the process - post-evaluation to avoid moral risks".
3. Enhance the Effectiveness and Comprehensiveness of Financial Supervision, and Figure out the Relationship between Central and Local Financial Regulation

3.1 Adhere to the finance controlled by Party serves as a significant core of the supervision system with Chinese characteristics

This financial work conference was named The National Financial Work Conference for the first time, which suggests the further emphasis on the Party's leadership over financial work and the future organizational leadership of the Central Financial Commission (in charge of coordinating policies), the Central Financial Working Committee (in charge of party building in the financial system), and local financial commissioners and financial working committees over national and local financial work. Strengthening the centralized and unified leadership of the Party Central Committee over financial work refers to the coordination and control. It shall take the advantage of the Central Financial Work Committee and effectively strengthen the Party building in the financial system. The reform of financial supervision agencies is of great importance in the new reform plan of Party and state institutions in 2023. After completing the institutional reform, the financial supervision authorities in China have established a structure of "one committee, one bank, one general bureau, one conference and one bureau", which helps to strengthen the coordination between the financial supervision and better prevent the systemic financial risks.

3.2 Strengthen the institutional supervision, behavioral supervision, functional supervision, penetrating supervision and continuous supervision

It shall actively explore a number of new supervision measures, and figure out the new concepts and methods of financial supervision. It is necessary to effectively improve the effectiveness of financial supervision, take all financial activities into supervision in accordance with the law, comprehensively strengthen the institutional supervision, behavioral supervision, functional supervision, penetrating supervision, and continuous supervision, eliminate the gaps and blind spots in supervision, strictly enforce the law, dare to show the blade and crack down on illegal financial activities. As for the theory and practice, the institutional supervision adapts to the objective reality of financial institutions operating separately in China. Functional supervision corresponds with the new trend of mixed operations in financial development. Penetrating supervision helps to better identify the risks, while behavioral supervision aims to protect the rights and interests of financial consumers. The above four form a closed loop and promote the formation of sustainable effectiveness in financial supervision. Taking the complexity of institutional reform and the innovation of the continuous development of financial formats into account, it is expected that the future reform of financial supervision institutions will keep optimizing and adjusting on the basis of it, which includes improving the functional supervision, strengthening the construction of macro prudential management systems, coordinating the supervision and interconnection of financial infrastructure, and promoting the sharing of comprehensive statistics and supervision information in the financial industry.

3.3 Figure out the the relationship between central and local financial supervision, implement the territorial responsibilities, and lay a foundation for better handling and resolving the risks

It shall take the advantage of the local party committees, financial committees and financial working committees, as well as implementing territorial responsibilities. Since the Fifth National Financial Conference was held in 2017, the relationship between central and local financial supervision has become one of the most important topics in the financial supervision. Then, the reform of local financial supervision began, and local financial supervision and management bureaus were established one after another, with the names of the Financial Work Office and the Financial Work Bureau. It clarified the scope of supervision for "7+4" types of institutions as well. However, in reality, the problems of the conflicts and multiple interests between financial development and the financial supervision will arise. It is necessary to cooperate with the central financial supervision agencies or implement the responsibilities to handle the risks. Therefore, it is difficult for the local government to keep a balance between the interests of two. Thus, in the institutional reform of this year, it removes the the development functions of local financial bureaus and clarify the specialized supervision.
4. Adhere to the Problem Orientation, and Clarify the Key Fields and Measures for the Future Financial Risks

In recent years, significant achievements have been made in the financial field along with the financial risks and drawbacks: "different contradictions and problems in the financial field are involved and affect each other, and some are obvious. There are many economic and financial risks and invisible crisis, the quality and efficiency of financial services for the real economy are not high, and the mess in finance and corruption exist with the weak financial supervision and governance capabilities." Therefore, we must make up our mind to solve the problems mentioned above. To make arrangements maintaining the financial security, the Ministry of State Security pointed out in the conference that the financial security plays an important role in the national security; At present, the financial security in China meets many risks and challenges, which include "short-looker", "short-doer", "short-talker" and "short-emptier", who attempt to ruin the confidence in the international community in investing in China; It shall be actively engaged in the construction of national security systems in the future economy and finance, and take close observation, accurate prediction and effective prevention of the national security risks in the finance, crack down on and punish the illegal and criminal activities that will threaten the national security in the finance in accordance with the law.

4.1 Timely handle the risks in small and medium-sized financial institutions

In recent years, the small and medium-sized banks have accumulated many risks in their development and operation. According to the China Financial Stability Report (2022) released by the People's Bank of China, the risks of financial institutions are mainly about the rural cooperative institutions and rural banks, and the number of these two types accounts for 92% of all high-risk institutions. Therefore, it is necessary to timely handle the risks of small and medium-sized financial institutions. Since 2019, the risk events have stricken some urban commercial and rural banks. Firstly, the urban commercial banks like Baoshang Bank have been emptied by the private capital, which infringed on the rights and interests of depositors and other shareholders. From 2005 to 2019, "Tomorrow Series" registered 209 shell companies and obtained credit funds from 347 loans with a total of 156 billion yuan, all of which became non-performing loans. Secondly, the problem of rural banks in Henan and other areas with the difficulties in withdrawing funds resulted from the lack of standardized corporate governance, as well as the risk amplified by banks promoting on the internet platforms, collecting deposits from other locations and online deposits. What's worse, there is financial corruption in rural banks and supervision systems. Thirdly, some local governments adhering to the abnormal views on performance interfere the operations in the local banks and increase the implicit liabilities. Small and medium-sized banks, which are highly bound to real estate and local financing platforms for a long time, bear a significant amount of implicit debt, fail to transform the models and functions, and keep accumulating the risks.

Resolve the handling risks in small and medium-sized financial institutions. Firstly, clarify the principles. According to the moral hazard, nature of bankruptcy and social impact, the handling measures of bank risks are divided into three types of administrative measures: lender of last resort measures (liquidity support), deposit guarantee measures, and administrative takeover measures, as well as two types of market measures: self-rescue measures and inter-bank rescue measures. Secondly, strengthen the territorial responsibility. In 2022, the Regulations on Local Financial Supervision and Administration (Draft for Comment) issued by the People's Bank Of China proposed the principle of "central unified rules, local supervision, and those who approve and supervise shall bear the corresponding responsibility". It sorted out the relationship between central and local financial supervision, and included different local financial formats in the unified supervision framework. Thirdly, promote the mergers and reorganizations. In the process of merger and reorganization, it shall focus on making out the purpose of the reorganization: the main purpose is to resolve the risks, and the treatment of non-performing assets during the merger and reorganization process should be given special attention; With the main objective of development, it shall conduct a comprehensive analysis on the current development status of the bank, and prepare a series of distinctive development strategies for the new bank.

4.2 Attitude towards the debt in the local government shifts from "strict control of new additions" to "long-term mechanism"

It shall establish a long-term mechanism for preventing and resolving the risks of local debt, create
a management mechanism of government debt that is compatible with high-quality development, and optimize the structure of central and local government debt. Compared with the conference in 2017, which emphasized "strictly controlling the increase of local government debt, lifelong accountability, and backward investigation of responsibility," the attitude of this conference towards the local government debt is significantly gentler. Served as a double-edged sword, the debt can promote the economic development but may result in some risks. Therefore, it is crucial to establish a management mechanism of government debt that is compatible with high-quality development. In the future, more scientific and reasonable aggregate control of local government quotas may be carried out to achieve the compatibility of incentives and constraints for the debt expansion of local government. To sum up, firstly, shift the focus on results to the process and system construction; Secondly, it shall be aware that the debt is both subjectively caused by local governments and objectively influenced by the environment; Thirdly, clarify that the objective of debt risk management is high-quality development, rather than reducing the absolute scale of debt. Optimizing the debt structure of central and local governments is an important means to optimize the structure of government debt as well as prevent and resolve the local debt risks in the future. Currently, the proportion of local government debt is high, and the overall risk of local government debt is controllable, but there are many potential risks in some regions; The proportion of central government debt is low, and it has more possibilities to increase the leverage.[9] The local governments have high borrowing costs and short cycles, while central governments have low borrowing costs and long cycles. Therefore, it is necessary to increase the proportion of central government debt and ease the contradiction between local government revenue and expenditure through transfer payments.

4.3 Promote a virtuous cycle between finance and real estate, and build a new model for real estate development

It shall enhance a virtuous cycle between finance and real estate, promote the supervision system and fund supervision of real estate enterprises, improve the macro prudential management of real estate finance, meet the reasonable financing requirements of real estate enterprises of different ownership equally, make good use of the policy toolboxes according to the conditions of different cities, better satisfy the demand for necessary and improved housing, accelerate the construction of the "Three Projects" like the affordable housing, and build a new model for the development of real estate[10]. With significant changes in the supply and demand relationship of the real estate in China, some risks have been gradually exposed in the real estate in recent years, such as the debt risk of housing enterprises, the risk of unfinished housing, and the continued decline in real estate sales and investment,, which have had a significant impact on finance, economy and other aspects. So it is necessary to take the real estate industry as a quasi-financial institution for macro prudential management in the long term, promote a virtuous cycle between finance and real estate, and build a new model for the development of real estate.

4.4 Financial risks with cross-region, cross-market and cross-border transmission resonance

It shall prevent the transmission of the risks in real estate. It is necessary to maintain the stable operation of the financial market, regulate the issuance and trading of the financial market, guide with reasonable expectations and prevent the risks with cross-region, cross-market and cross-border transmission resonance. It shall strengthen the management of the foreign exchange market and keep the RMB exchange rate basically stable at an appropriate and balanced level. What’s more, it is necessary to properly separate the production from financing risks. And efforts should be made to promote high-level financial openness and ensure the security of national finance and economy.

5. Conclusion

To strengthen the supervision, in addition to improving the systems, it is also necessary to build a loyal, clean and responsible professional supervision team. Since 2023, the efforts for anti-corruption in the financial industry have continued, and the number of people under investigation has increased significantly compared with last year, suggesting China's strong determination in purifying the environment of financial market. From the information released by the financial supervision authorities, adhering to the principle of the blade inward and strengthening “Supervision on Supervision” will become a focus for comprehensively enhancing the financial supervision in the future. Effective prevention and control of financial risks are the eternal theme of financial work and the direct goal of
It shall issue the special bonds for small and medium-sized banks to supplement their capital; It shall adjust and optimize the credit policies of real estate; It shall establish a long-term mechanism for preventing and resolving the risks of local debt. Since 2023, under the protection of financial supervision, a variety of measures to prevent and resolve the risks have been carried out orderly, with stable operation of the financial industry in China and strong ability of risk resistance. As of the end of the third quarter, the non-performing loan ratio of commercial banks reached 1.61%, the provision coverage rate reached 207.89%, the capital adequacy ratio reached 14.77%, and the comprehensive solvency adequacy ratio of the insurance industry reached 194%. Keeping a balance on the development and security is the key to the good financial work. The launch of 25 measures helps to continuously strengthen the financial services for private enterprises; It shall further improve the statistical monitoring and assessment system for green finance; It shall meet the reasonable financing needs of real estate enterprises with different ownership systems equally. In 2023, guided by the financial supervision, the financial resources will transmit to the key fields and weak links, which helps to improve the quality and efficiency of serving the real economy. With the comprehensive strengthening of financial supervision, the prevention and control of financial risks will become more effective, and finance will provide higher quality services for the development of economy and society.

References