

# Commercial Bank Loan Risk and Prevention

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**Abstract:** Under the environment of China's market economy, the healthy and stable development of commercial banks is an important guarantee for the healthy operation of the social and economic system. As an important part of the financial management system, credit management of commercial banks is not only related to the sound development of commercial banks, but also has a direct impact on the stability of the whole society. At the same time, risk factors in financial activities are always following, and if there is no reasonable avoidance and prevention of financial risks, it will affect and threaten the survival of financial institutions. In such a situation, commercial banks should attach great importance to the prevention and control of loan risks, establish reasonable control strategies based on the actual situation, optimize the risk management system, continuously improve the level of risk management and control, ensure that the healthy operation of the financial system has good depth and breadth, and lay a solid foundation for the sustainable development of commercial banks. This paper discusses the risk and prevention of commercial bank loans from the aspects of the concept and characteristics of commercial bank loan risk, the current problems in the risk management and control of commercial bank loans, and the countermeasures to the risk management and control of commercial bank loans, so as to provide reference for promoting the healthy development of the financial industry and standardizing the management of financial enterprises.

**Keywords:** Commercial banks; Loan risk; Risk prevention and control.

## 1. Introduction

With the rapid development of China's market economy, the scope and scale of credit business, as the main profit channel of commercial banks, are expanding, and the potential risk factors of traditional commercial banks' credit business are also increasing.

## 2. The Concept and Characteristics of Commercial Bank Loan Risk

### 2.1. The concept of commercial bank loan risk

The risk of commercial bank loans refers to the possibility that the borrower or counterparty of the bank fails to perform its obligations in accordance with the agreed terms, so the borrower cannot repay the principal and interest of the loan on time or fails to repay it within the time limit, resulting in changes in the income of the commercial bank. Credit business is the main source of profits for commercial banks, and for most commercial banks, in order to achieve the goal of maximizing shareholder value, commercial banks need to strive for the highest rate of return within their own acceptable risk range. As yields rise, commercial banks also have to take greater risks and effectively manage the corresponding loan risks.

### 2.2. Risk characteristics of commercial bank loans

(1) Objectivity. The objectivity of loan risk refers to the objective existence of loan risk, no matter how perfect the risk control system of the financial institution is, how high the level of operation and management, and how high the credit rating of the borrower, the borrower will face the risk of not repaying the principal and interest on time when carrying out loan business.

(2) Uncertainty. It is difficult to predict if, when, and the size of the amount that will be difficult to recover.

(3) Concealment. Usually, the risk of a loan appears before or after the loan is disbursed, but the loss caused is not immediately apparent and remains a façade.

(4) Controllability. Financial institutions predict, prevent, avoid, and resolve loan risks through system and process control.

(5) Double-sidedness. Loan risk will bring losses to financial institutions, and at the same time, it can also prompt financial institutions to establish and improve risk compensation mechanisms and risk protection systems to achieve healthy and sustainable development.

(6) Diffusion. Once the loan risk erupts, it will not only cause losses to the financial institutions themselves and affect their survival and development, but will also spread rapidly in other financial systems, and even affect the stability of the entire financial system and trigger a financial crisis.

## 3. Problems Existing in The Risk Management and Control of Commercial Banks' Loans

At present, commercial banks have formed control measures for credit risk, but they are still not sound, and there are mainly the following problems:

### 3.1. The ability to investigate loan information is still lacking

Credit risk is related to the problem of information asymmetry, that is, adverse selection and moral hazard. Borrowers tend to have easier control of their financial situation and risk profile than commercial banks before making a loan, so those who are too risky tend to borrow from bank even in the face of higher interest rates, which is adverse selection. After successfully obtaining a loan from a commercial bank, the borrower may also take the risk of making a "high-risk, high-return" investment that is not well known to commercial banks, which is moral hazard. The ultimate result of information asymmetry is that it is difficult

for commercial banks to recover the principal and interest of loans and bear the loss of credit.

Credit investigation is a good medicine to prevent information asymmetry, but the current credit investigation of commercial banks is usually limited to the examination of the financial information of the enterprise: financial statements and financial reports, tax statements, bank account information, etc., and the authenticity and accuracy of the business transactions of the enterprise, the strategic planning of the enterprise, the operation management and other information closely related to the overall comprehensive relationship of the enterprise are insufficient, and it is difficult to fundamentally solve the serious problem of borrowers whitewashing and beautifying financial information in order to obtain loans.

### **3.2. The loan evaluation index is not perfect**

According to theoretical knowledge, commercial banks currently also have relevant traditional credit risk surrogate indicators, such as "total loans/total assets, non-performing-loans/total loans, loan losses/total loans, and loan loss provisions/Total assets", these ratios apply to the different types of loans held on a bank's balance sheet, but these indicators lag behind the earnings data, and most of the above data is already happening in the real world, making it relatively difficult to predict the future. The perfect credit risk assessment system is scientific in evaluation methods, advanced means and sufficient information support, and the current loan evaluation system of commercial banks needs to be optimized and upgraded.

### **3.3. Lack of loan management capacity of commercial banks**

(1) Lack of ability to use technology. At present, with the rapid development of information technology, the corresponding telecommunication supervision procedures have also been applied, but the scope of application is small and the management ability is weak; Many small and medium-sized banks are limited by the implementation and application of information technology, and rely too much on manual work in the loan process, resulting in the loan process being interfered by human factors, which is not objective and fair.

(2) The internal risk management system and loan review management system are immature. China has been reforming, promoting, and improving the corresponding rules and regulations of commercial banks, and the internal risk management system and loan review management system are immature, which in turn affects the disadvantages of decentralized organizational structure, low efficiency, and unclear division of labor.

(3) Formalized post-loan control, failure to discover and control loan risks in a timely manner, resulting in losses. Most commercial banks believe that with collateral, they can "sit back and relax", so they ignore the follow-up management after the loan, and can only passively accept the credit loss when it appears; Some commercial banks are worried about the risk of customer loss, and in the face of lenders' implementation of the "three noes" policy, that is, they do not ask, do not care, and do not know. As a result, the loan risk occurs.

### **3.4. Systemic risks of loans are still difficult to solve**

Loan risk can be divided into unsystematic risk and systemic risk, and unsystematic risk refers to the credit risk borne by holding a loan or securities of a specific enterprise due to micro factors. Unsystematic risk can be mitigated by diversifying your investments.

Systemic risk refers to the risk that the probability of default of all enterprises increases at the same time due to changes in the macroeconomic environment or the occurrence of certain events that have a serious impact on the real economy/market, such as the global economic crisis. Therefore, the systemic risk of lending has not been effectively addressed.

## **4. Measures to Deal with The Risk Management and Control of Commercial Banks' Loans**

In order to ensure the effective operation and standardized management of commercial banks, and to avoid and reduce the impact of loan risks on the operation and efficiency of commercial banks as much as possible, this paper gives the following suggestions:

### **4.1. Conduct a bank customer qualification assessment**

For the stable old customer group accumulated over the years, the bank should continue to maintain a good customer relationship, and a stable customer relationship is an important resource for the bank. Banks tend to have a more comprehensive and accurate grasp of the information of stable old customers, and are familiar with their specific deposit and loan conditions.

For new customer groups, banks should strengthen pre-loan review, comprehensively examine and evaluate the development status and prospects of customers in the industry, and objectively assess the credit status and solvency of customers. Form a corresponding reward and punishment mechanism, for enterprises that can repay the loan principal and interest on time, they can give appropriate loan cooperation or loan commitments, and appropriately reduce the loan interest rate to lend to them. For those who find it difficult to repay the loan on time or even do not repay it, the loan threshold will be raised or they will be included in the list of dishonest persons, and they will be refused to provide loans again.

### **4.2. Commercial banks should properly control their own capital liquidity and capital adequacy**

As far as commercial banks are concerned, "borrowing short term and lending long term" is a distinctive feature of commercial banks' borrowing and lending business. The so-called "borrowing short term and lending long term" refers to the fact that commercial banks accept short-term deposits from depositors for one year or less, and use these deposit funds for longer-term loans. Some commercial banks pay attention to the high returns on the surface, ignore liquidity management, and use a large amount of funds for loans, which can easily lead to the existence of risks such as runs.

In terms of liquidity management: increase reserves with the central bank to cushion the risks faced.

In terms of capital adequacy management, commercial banks should appropriately increase their capital stock as a necessary buffer to absorb potential losses.

It is true that commercial banks will indeed sacrifice the opportunity to gain benefits by improving their own liquidity. However, in the face of external risks, it is indeed an effective measure to improve their own ability to resist risks, so commercial banks themselves should also make a rational trade-off between benefits and security.

Commercial banks themselves should also regularly send good signals to the market, and the reason why credit risk occurs is also determined by the confidence of depositors and lenders in commercial banks.

### **4.3. Improve the pre-loan investigation mechanism to improve the understanding of pre-loan information**

In view of the above-mentioned credit risks caused by information asymmetry, it is very important to prevent adverse selection in the early stage. To know the authenticity of the lender's information before the loan. It can be done in the following ways:

(1) In the credit assessment, it is necessary to comprehensively review the application conditions, qualifications, repayment ability and willingness of credit applicants, as well as financial statements, and commercial banks should pay attention to the study of corresponding indicators such as cash flow; According to the relationship between the balance sheet, income statement, cash flow statement and other financial statements, ensure that the report information is accurate and fully grasp the accurate information that can be grasped.

(2) Focus on verifying whether there is an obvious or implicit relationship between the business unit of the lending enterprise and others; Verify the authenticity of the company's transaction information, business changes and capital flows.

(3) Adopt a variety of ways and methods to improve the authenticity of the investigation. Utilize a variety of analysis models to analyze the future development path of the company. In addition to paying attention to the regular financial data, we should also focus on observing and analyzing the non-financial information of the enterprise, that is, "soft information", and collect all the observable data as much as possible to understand the overall situation of the enterprise's operation more comprehensively and truthfully.

### **4.4. Strengthen post-loan follow-up management**

(1) To change the awareness of "heavy lending and light management", the pre-loan information search and post-loan supervision and control should be placed in the same important position. With the rapid development of scientific and technological information in today's world, science and technology finance has become a new trend in the development of the financial system. Commercial banks should seize the opportunity of technological development, actively apply financial technology, strengthen the quality of post-loan supervision, and improve the efficiency of financial credit.

(2) Commercial banks should strengthen the supervision of borrowers' accounts and supervise the changes in borrowers' accounts. When there is a large-scale change in the amount, banks should be vigilant and take appropriate action.

(3) The collateral can be used as security for the loan to

reduce the risk of the loan, and if the lender is unable to repay the loan on a regular basis, the lending institution can auction or sell the collateral to recover the outstanding loan amount in accordance with the terms of the contract. Therefore, for special types of loans, increasing the collateral amount of the loan is also a wise move to reduce the loan risk.

### **4.5. Strengthen the construction of internal control of commercial banks and improve the monitoring and control system**

(1) When handling credit business, strictly implement the internal control system, business process, and post authority standards, strengthen the internal containment mechanism for incompatible positions, implement risk management and control over the entire business process, and prevent the occurrence of violations.

(2) Implement the system of separating the examination and approval of loans, implement the review and approval powers of loans to different functional departments, clarify the work scope, job responsibilities and work authority of the loan review department and the loan approval department, and improve the quality of work.

### **4.6. Cultivate professional ethics of employees**

Banks are important members of the financial system, and bank staff must have good moral standards and professional ethics, and have strong self-restraint and self-control capabilities. To cultivate good professional ethics of employees, it is necessary to comprehensively improve the quality of employees from the aspects of morality, legal system and business. Let employees understand legal knowledge and financial knowledge, and truly know and respect, guard against fear, and abide by the bottom line; Comprehensively enhance the employees' awareness of the rules of "don't want to do, dare not do, and can't do", and establish a good atmosphere of integrity, honesty and self-discipline, and disciplined management; Banks should also improve the post responsibility system, which is mainly interpreted from two aspects. On the one hand, the responsibility should be assigned to every department and every person to prevent the occurrence of illegal phenomena. On the other hand, banks need to avoid delegating multiple tasks to one person; Or put multiple tasks in the hands of people who are closely connected.

### **4.7. Clarify its own market positioning and carry out high-quality cooperation**

There is also a correlation between the market positioning of commercial banks and the business they carry out. Commercial banks should clarify their market positioning, and at the same time understand the information of the enterprise, they should also clarify the development direction and audience of their own new products. Commercial banks can strengthen exchanges and cooperation with current projects supported by the state and society, such as cooperation and exchanges with green industries and new energy industries, which is also an effective way to avoid credit risks.

## **5. Summary**

In China's financial market, commercial banks play an important role in stimulating market vitality and promoting social and economic development. At present, China's

financial market has been gradually improving, and the adaptability of the socialist market economic system supporting it is also constantly developing. At the same time, commercial banks will also encounter many new problems and unknown dangers in the process of development. Commercial bank loan risk is a normal manifestation of financial risk. Therefore, it is necessary to strengthen the analysis and research of commercial banks' loan risks, establish an effective risk prevention and early warning system, and carry out scientific and effective risk management and control, so as to achieve the greatest degree of control and reduce the losses caused by risks. Analyzing and studying how to prevent and control the loan risks of commercial banks is of great significance to improving the overall strength of commercial banks, enhancing their competitiveness in the financial market, and promoting the healthy development of the financial industry.

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