

# Case Analysis of 3 Billion Fake Financial Management Internal Control Failure of Minsheng Bank

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**Abstract:** This paper aims to analyze the 3 billion cases of fake wealth management products of Minsheng Bank in 2017, discuss the causes of the case from the perspective of internal control failure, and summarize the enlightenment of the case to the internal control of commercial banks in China, mainly including the following research contents: First, from the origin and evolution of internal control theory, the commercial Banks internal control theory and evolutionary game from three perspectives in the application of internal control theory of internal control for overview; Second, from the overall situation of internal control in China's banking industry, the minsheng bank false financial product case a panoramic review and analysis, from the Angle of empirical observation of minsheng bank failure reasons of internal control, influence and inspiration are summarized; Third, build an evolutionary game model, from the perspective of internal control to discuss the evolution of the people's livelihood bank head office and branch path and stable strategy, and sums up the head office and branches in steady and unsteady state strategy choice; Fourthly, combined with theoretical analysis, case analysis and evolutionary game model analysis, this paper puts forward targeted countermeasures and suggestions from the two aspects of stable and unstable strategy states. The main conclusions of this paper are as follows: first, in the fake financial management case of Minsheng Bank, the strategic choices of head office and branches change dynamically in the long run; Second, the strategy choice of branches depends on whether the head office carries out strict internal control and the punishment of branches after carrying out strict internal control; Thirdly, the main ways for the head office to improve internal control are to increase the proportion of business sharing of branches and to increase the punishment. This article possible innovation lies in: one is to choose the minsheng bank false financial case as the breakthrough point analysis of commercial Banks internal control failure problem; Second, in the evolutionary game model, the author analyzes the reasons of minsheng bank internal control failure, and considering the bounded rationality, head office and branch; Thirdly, the evolutionary game model is used to analyze the evolution process of the strategic choices of the head office and branches in a long period of time.

**Keywords:** Minsheng Bank; Wealth management products; Internal control; Evolutionary game.

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## 1. Research Background

Party's 19 are pointed out and the central economic work conference in 2018, guard against and defuse financial risks as the first battle of the "three big battle", in relation to national security, the development of the country and people's property security, for major potential obstacles in the process of quality development. In recent years, the concept of commercial bank financial products in the novel, stable depositors watches etc., however, the problem such as false advertising, false solo single will it to the wind wave pointed mouth, and the listed commercial bank financial products store the features of large flow, high speed also cause risk concentration, competing astonishing, even cause social impact, threaten the stability of the financial system. 1 billion false guarantee guangdong development bank, agricultural bank, for example, 1.4 billion chapter "turnip" financial fly, minsheng bank 3 billion flying false financial case, icbc's 5.47 billion financial products suspected violations in heilongjiang province, Shanghai pudong development bank 77.5 billion loan fraud, etc.

Since the reform and opening up, our country residents income kept stable and fast growth, traditional way of savings deposits is increasingly unable to meet the diversified investment demand of residents, under the diversified financial investment demand, at the same time in order to full of competition and challenges in the banking sector to keep the core competitiveness, commercial Banks also accelerated the pace of expansion traditional intermediary business, In

order to maintain core competitiveness in the competitive and challenging banking industry, commercial banks have also accelerated the pace of expanding traditional intermediary business. In the process of financial product is hot, the commercial Banks in the design of financial products, often using set high expectations yield to attract investors. Based on this, some high liquidity requirements of financial products, such as short-term financing and pools of capital financing by commercial Banks, the rapid growth of the profitability on this implementation itself. According to statistics, by 2018 1 quarter, financial products on the market, the remaining open to individual investors expected return type of a total of 167901 kinds of financial products. Among them, the full open a total of 111538 kinds of products, 18874 kinds of increase from the previous period; There were 55,926 semi-open products, 3280 more than the previous period; There were 167,344 kinds of products with relatively complete yield disclosure. Commercial bank financial products soared at the same time, all kinds of irregularities also emerge in endlessly, according to the China banking regulatory commission in the first quarter, according to the first three months of 2018 for 973 tickets over the confiscated amount accumulative total more than 1 billion yuan, control key tend to commercial Banks internal control failure.

More importantly, under the background of continuous innovation and launch of financial products, various illegal operations with strong concealment have also multiplied. In particular, some financial group, holds the country's economic lifeline in the maintenance of national financial

security and stability and promote the sustained and rapid development of the economy play a major role, but because of the internal control on financial product failure, financial system with major impact on the whole economy, a threat to social stability. In this context, the author selected the 2017 minsheng 3 billion false financial product case discussion, analyzing the problems of internal control of commercial bank failure, this undoubtedly for commercial Banks to strengthen internal control management has important practical and theoretical significance.

## **2. Second, the Literature Review**

### **2.1. Internal Control and Risk Supervision**

Both theoretical analysis and empirical research show that the quality of internal control is significantly positively correlated with the enterprise's ability to resist risks (Fang Hongxing and Chen Zuohua, 2015). The stronger the enterprise's ability to face risks caused by economic fluctuations or market fluctuations is, the stronger it can fully weaken the negative impact of external factors and control the system risk level within the tolerable range (Hauswald, 2006). This situation is particularly obvious in non-state-owned listed companies, where the quality of internal control is highly correlated with the material misstatement rate and error of corporate performance statements, which saves a lot of time and cost for audit work (Li et al., 2018; Berger et al., 2002). At the same time, Xu Hong (2017) study, such as in the case of corporate performance decline is seen after the IPO, the decline from the impact of the risk investment, high quality of internal control can help the enterprise to weaken the negative effect, and the impact of the risk investment, the greater the high quality of internal control are more significant role.

### **2.2. Internal Control and Executive Incentives**

Wu Chengsong (2016), based on bank risk bearing Angle, such as using Chinese listed Banks from 2001 to 2012

Panel data, and estimate the risk of bank executives to pay sensitivity, he pointed out that risk-taking and present a significant negative correlation between executive compensation, executive pay is embodied in the function of risk bearing restriction function, namely the risk of China's listed bank executive compensation incentive sensitivity is higher. Chen Xiaodong etc. (2016) the research conclusion and Wu Chengsong (2016), he adopted financial listed companies from 2006 to 2013 panel data for empirical analysis found that executive equity incentive and there is a certain relationship between the enterprise investment decision, and received the building enterprise incentive effects of equity incentive mechanism, Our country finance risk of enterprise executive pay higher sensitivity to the same.

### **2.3. Internal Control and Governance Structure**

Amine (2014) pointed out that among the factors affecting profitability and level, the high concentration of control rights was an extremely important reason. In particular, the governance mode of the board of directors, which exercises management power on behalf of the general meeting of shareholders, has an important and irreplaceable impact on the internal control of enterprises. For example, Xie et al. (2017) selected the data of listed companies for empirical research and found that internal control

The effectiveness of the internal control system is significantly positively correlated with the shareholding ratio of directors, the proportion of independent directors and the establishment of audit committee, and the probability of the failure of internal control is greatly increased when the CEO and chairman of the board are the same person. At the same time, a large number of scholars pay attention to the relationship between the quality of internal control and corporate profits, and propose that corporate power distribution has a negative moderating effect on the quality of internal control and corporate profits, and once again confirm that the CEO and chairman holding the same position will weaken the positive effect of internal control. It also points out that independent directors can significantly positively affect the quality of internal control and corporate profitability (Hu, 2018).

## **3. Research Methods**

This paper aims to analyze the case of fake financial products of Minsheng Bank to study the reasons for the failure of internal control of commercial banks and put forward countermeasures and suggestions. Two research methods are adopted to carry out the research:

The first is case analysis. This paper takes Minsheng Bank as the research object, through the introduction and analysis of the fake financial management cases of Minsheng Bank, the current internal control problem of the banking industry is deeply explored, and on this basis, the solution strategy of the internal control problem of the banking industry is elaborated in detail.

The second is empirical observation method. This paper conducts a panoramic review of 30 fake financial management cases of Minsheng Bank, draws views from the theory of internal control failure, and summarizes the causes and effects of internal control failure of fake financial management cases based on realistic observation.

The third is the evolutionary game model. In order to make the strategy more targeted, more objective analysis on the absence of banking internal control problems, this paper constructs the basic conditions of evolutionary game model between the head office and branches, the paper studies the internal control of the internal control perspective, the head office and branch the dynamic change of strategy selection, and discusses the steady and unsteady strategy choice under the head office and branch evolution process of the strategy, This paper reveals the deep reasons for the fake financial management cases of Minsheng Bank.

## **4. Case analysis of Minsheng Bank's Fake Financial Management**

### **4.1. Case Background Introduction**

In early April 2017, the illegal and illegal sale of fake financial products by Hanganqiao Sub-branch of Beijing Branch of Minsheng Bank was exposed by many media. This financial product fraud case attracted rapid attention due to the huge amount of money involved, wide involvement and bad social impact. In an announcement posted on its official website, the head office of Minsheng Bank noted: "Recently, the company reported to the public security department on the suspected illegal behavior of Zhang Ying, president of the Hangzhouqiao Sub-branch of Beijing Branch, and Zhang Ying has been taken away by the public security organ and is

under investigation by the public security department. The company has set up a working group to actively assist the public security department in the investigation. The amount of money involved and the specific circumstances of the case reported by the media are in the process of investigation. The company strives to find out the facts as soon as possible, protect the safety of customers' funds to the maximum extent, properly solve the demands of all parties, and assume relevant responsibilities according to law."

Subsequently, a few media followed up the investigation report, and the victims who bought the fake financial products of Minsheng Bank spoke out collectively. According to preliminary estimates, the amount of illegal financial management involved was about 3 billion yuan. At this point, commercial banks began to strengthen self-examination and self-correction, strictly check the "flight order" situation, and continue to find a few cases of selling fake financial products. Finally, in November 2017, the Beijing Banking Regulatory Bureau issued a penalty sheet, giving Minsheng Bank 27.5 million yuan fine administrative penalty, and ordered the Beijing branch of Minsheng Bank to rectify the case immediately.

Minsheng bank in to the public security organ after, established a special processing of the event processing team, make the following preliminary settlement decision: first, actively cooperate with public security organs to find out the fact that zhang ying to sell fake products; Second, the bank initiated an emergency plan to compensate the private bank clients' funds on the basis of finding the facts; Third, it is willing to bear the legal liabilities arising therefrom and properly solve the victims' demands; Fourth, immediately obey and implement relevant regulatory laws and regulations, fully disclose the information of false financial management cases to the market as soon as possible, and put the rights and interests of the victims of investors in the first place. After Minsheng Bank issued the announcement, the bank operated normally, and the risks brought by the fake wealth management products were basically controlled.

## 4.2. Cause Analysis of Internal Control Failure

(1) Organizational structure reform is not in place

From the case of fake wealth management products of Minsheng Bank, one of the main reasons for the failure of internal control is the inadequate organizational structure reform, which mainly includes:

First, the division of labor and responsibilities between the management and the business level is unreasonable. According to the "Guidelines on Internal Control of Commercial Banks", most of China's commercial banks have established a corporate governance structure of "three returns and one layer", which stipulates the internal control responsibilities of the management and the business layer in detail. However, the director of the loan examination committee of Minsheng Bank Aerospace Bridge Sub-branch is still the president. The president of the bank acts as both a referee and an athlete, making loan applications and participating in loan examination and approval. The approval power and decision-making power are not strictly separated.

Second, the supervision responsibility of relevant business departments is absent. Although the flat management mode helps commercial banks give full play to their independent competitive advantages, the superior banks of most sub-branches are under business operation pressure at the same time and take a negative attitude towards the supervision and

management of the subordinate banks, which ultimately weakens the management of the grass-roots banks and transfers the responsibility of risk control and management to the subordinate banks. For example, the Aerospace Bridge Sub-branch of Minsheng Bank can "make the account statement clear in one hand". The internal control mechanism is virtually non-existent.

(2) Insufficient control and decentralized control coexist

In fact, the internal control failure of Minsheng Bank has long attracted the attention of banking regulators, and the Aerospace Bridge Sub-branch of Minsheng Bank is not an individual case. As early as 2012 and 2013, the Shanghai Banking Regulatory Bureau found that some employees of the Shanghai Branch of Minsheng Bank sold wealth management products without authorization, and imposed an administrative penalty of 500,000 yuan on the Shanghai Branch of Minsheng Bank, pointing out that the bank had the contradiction of insufficient control and decentralized control, and the internal control level needed to be improved.

First, the internal control is insufficient. Like other commercial banks, Minsheng Bank has generally implemented the account manager system in the bank for the purpose of maximizing marketing benefits. However, Minsheng Bank has insufficient control over the management of account managers: first, there is no assessment system for account managers, and the quality and ability of account managers are uneven; Second, it is difficult to supervise and restrict the various behaviors of account managers, and the incidents of account managers handling various kinds of business in violation of regulations in exchange for their own interests emerge one after another. The lack of internal control over account managers eventually led to a risk control vacuum in Minsheng Bank.

Second, the responsibilities of the board of supervisors were dispersed. According to China's Commercial Banking Law, the board of Supervisors should assume the responsibility of supervising all business activities of the bank and immediately correct any violations of laws and regulations found in the handling of business. However, in the case of Hanganqiao Sub-branch of Minsheng Bank, the board of supervisors of its superior bank had obvious problems of decentralization of responsibilities, and the board of supervisors in name only failed to fulfill its responsibility of comprehensive supervision.

(3) Performance incentive mechanism is distorted

From the perspective of commercial banks' efficiency principle, there is nothing wrong with pursuing the maximization of profits. However, the precondition of the efficiency principle is to maintain the safety of banks. In the case of Minsheng Bank's fake wealth management products, the distorted performance incentive mechanism is also one of the important reasons leading to the crime. In recent years, the performance appraisal mechanism of China's commercial banks has become more and more strict, and there are some problems such as lack of communication with employees and forced setting of excessive appraisal targets, which ultimately lead to the distortion of the compensation incentive mechanism of banks. On the one hand, because of some employees, branch objective, it cannot be too high, loss of confidence in doing business; On the other hand, the incentive mechanism completely deviates from the employees' goals, and the incentive mechanism is derailed and non-existent, so the banking industry does not get additional benefits from the performance incentive. Therefore, it is necessary to set up a

reasonable performance incentive mechanism consistent with employees' goals while strictly controlling the internal system.

#### (4) Information communication obstruction

From the case of fake financial products of Minsheng Bank, the information of financial products needs to be further disclosed, and there is obvious obstruction in the information communication between the front, middle and background. At the front desk, due to the bank's consideration of saving transaction costs, most of the financial product sales staff have not undergone strict training, and they are basically "laymen" transferred from various positions, rather than financial product sales specialists. These financial product salespeople lack basic professional quality. In pursuit of sales goals when promoting financial products to customers, they often exaggerate the advantages of financial products, fail to explain the risks of financial products to investors, and fail to disclose the flow of financial funds, financial product returns and other information to investors, which makes investors unable to accurately evaluate the risks. What is more worrying is that even though some financial product salesmen are fully aware of all kinds of financial product information, they may choose to conceal the relevant information of financial products or even beautify the defects of financial products for the pursuit of performance, resulting in huge economic losses to investors.

### 4.3. Impact of Events

#### (1) Impact analysis on Minsheng Bank

The case of Minsheng Bank's fake financial products is a typical case of failure of internal control. The head office's lack of supervision over branches, lack of management of important business risks, and the branch's taking risks to seek huge profits to carry out illegal business, caused huge economic losses to Minsheng Bank, and plunged Minsheng Bank into a major reputation risk. At the same time, this major risk event also caused a huge negative impact on the overall development of China's banking industry, and even became the trigger of financial systemic risk. Specifically, the case of fake wealth management products of Minsheng Bank has brought about two impacts on Minsheng Bank.

First, several senior executives of Minsheng Bank were punished. The Beijing Banking Regulatory Bureau has disqualified Zhang Ying from serving as a director for life and given her a decision to cancel her senior management, while explicitly prohibiting her from working in the banking industry again. In addition, Xiao Ye and He Rui were banned from the banking industry for life. Wang Tao, Wang Xiaohong, Li Yahui, He Shuqiong, Wang Fei, Wang Qiuyu and Kui Yanan were banned from working in the banking industry for one year. Zhang Jian and Zhou Jin were given a warning and fined 500,000 yuan, respectively. According to incomplete statistics, more than 30 senior executives of Minsheng Bank were affected by the incident.

Second, the market value of Minsheng Bank has fallen sharply. From the perspective of the securities market, the negative public opinion caused the stock price of Minsheng Bank to fall all the way after the fake financial products case. As shown in Figure 3.3, although the stock price of Minsheng Bank showed a continuous downward trend in the first quarter of 2017, it fell off a cliff in early April after the incident, and fell for 29 consecutive trading days after the incident, once falling to a new low since 2015. The most direct manifestation is that the stock price of Minsheng Bank directly fell by the daily limit on the second day of the incident, with the stock

value fluctuating sharply and the company's market value declining sharply. At the same time, when the Beijing Banking Regulatory Bureau imposed administrative penalties on Minsheng Bank, the stable stock price of Minsheng Bank in the early stage fluctuated and fell again, which directly affected the market value of the bank.

#### (2) Analysis of the impact on the banking industry

According to incomplete statistics: in terms of the number of penalties, the banking industry received a total of 2436 administrative penalty decisions in 2017, and 1386 banking financial institutions were punished. The number of administrative penalty decisions and penalty institutions doubled compared with 2016; In terms of penalty amount, in the first nine months of 2017, a total of 70 million yuan of illegal income was confiscated, and a total fine of 555 million yuan was imposed, which was more than twice that of 2016. Under the strict supervision, on November 30, 2017, the official website of the CBRC issued four fines in one day. In addition to the above-mentioned punishment on the Beijing branch of Minsheng Bank, the Beijing Banking Regulatory Bureau imposed a penalty decision on the Beijing branch of Agricultural Bank of China and the Beijing Haidian Sub-branch of Agricultural Bank of China on November 22 and November 28, respectively, with each fine of 500,000 yuan.

#### (3) Analysis of the impact on financial consumers

In the case of 3 billion yuan of fake financial management of Minsheng Bank, it has the greatest impact on financial consumers, and brings huge losses to financial consumers who buy fake financial management cases. As shown in Table 3.3, according to incomplete statistics, a total of more than 150 financial consumers caused losses due to the purchase of fake financial management cases. At the same time, when Minsheng Bank Beijing Hanganqiao Sub-branch sold the fake financial products, it chose the senior customers of private banks in its own industry to cheat, so the amount of fake financial products purchased by a single customer was relatively high, and the total amount of fake financial products exceeded 3 billion yuan.

More importantly, the case of the fake wealth management products of Minsheng Bank brought unstable expectations to financial consumers. After the case of the fake wealth management products of Minsheng Bank, many victims gathered to protect their rights in Minsheng Bank. At the same time, there is even a sharp decline in the trust of financial consumers in banks, and a run on financial products or various kinds of bills.

## 5. Countermeasures and Suggestions

### 5.1. Improve the Setting of Performance Commission Ratio

Combining the results of evolutionary game model analysis and the case of Minsheng Bank, we can find that it is a low-cost and efficient way to conduct effective internal control through reasonable setting of performance ratio. When the strategic choice of the head office and branches is unbalanced, and the strategic choice of branches tends to "maximize their own interests", setting a reasonable performance commission ratio can compress the extra income brought by the branch's trust-breaking, and then promote the branch's strategic choice to evolve to the goal of "maximize the interests of the head office". In the real case of China Minsheng Bank, a dynamic performance commission ladder ratio can be set in the management of branches, which can be dynamically adjusted

and changed according to the profits created by branches for the head office. The more the profits created by branches for the head office, the greater the proportion will be, and the branch's strategic selection will evolve to the goal of "maximizing the profits of the head office".

## 5.2. Increase the Punishment of Illegal Business

When increasing the performance commission ratio, another problem may arise. Branches take risks in pursuit of higher commission ratio, that is, the strategic choice of branches will evolve to the goal of "maximizing their own interests" again. At this point, it is necessary to increase the punishment of illegal business measures to ensure that the internal control mechanism is not abnormal. In the evolutionary game process between the head office and the branch, the focus of the branch is on the amount of extra income. Therefore, under the condition of increasing punishment for handling illegal business, the cost of deviation from the target of the branch is increasing, the loss it needs to bear is increasing, and the extra income is constantly compressed, and even the income when it chooses the goal of "maximizing the interests of the head office" is affected. Therefore, in the long-term evolution process, the strategic choice of branches tends to the original established goal. Specifically, considering the problem of internal control cost, the head office can choose the method of "regular inspection + surprise inspection" to carry out spot check when formulating the internal control mechanism, so as to prevent branches from deviating from the original target strategy selection in the long-term evolutionary game. In this unstable state, the long-term evolutionary game between the head office and branches will encourage them to build a good mutual trust relationship, promote the overall interests of the bank with low-cost and efficient internal control mechanism, and give full play to the collective advantages of the whole bank.

## 5.3. Establish a Good Trust Relationship Between the Head Office and Branches

In reality, considering the cost, it is the first strategy choice of the head office not to carry out strict internal control. The head office's choice to trust branches will create greater benefits for the head office. That is, the evolutionary game model is in the initial state, and a good mutual trust relationship is established between the head office and branches. When the internal cost is close to zero, the profit of the whole bank can be maximized, and the overall advantage can be fully brought into play. However, with the change of branch strategy selection in the evolution process, the branch

will tend to evolve to the goal of "maximizing its own interests", the head office will tend to choose strict internal control strategy, the branch will evolve to the goal of "maximizing the interests of the head office" again, the head office will evolve to the direction of loose internal control again, in the long run, the head office and the branch cannot reach the optimal state into an infinite cycle. In this case, only by improving the performance commission ratio, increasing the punishment of illegal business, and ensuring that branches do not evolve to the goal of "maximizing their own interests", can we promote the establishment of a good trust relationship between the head office and branches in the long-term evolution process.

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