



Credit risk management of commercial bank

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ABSTRACT

Credit risk is a result of the loan business of commercial banks. The definition of credit risk, on the one hand, refers to the uncertainty of whether borrowers can keep servicing the loans or not; On the other hand, it refers to the possibility of bank crisis due to the formation of a large number of non-performing loans. Commercial bank is a kind of enterprise which pursuing maximum profit is its ultimate goal. Credit business is the core business of commercial banks, and credit assets account for quite a large proportion of total assets, therefore, the size of the credit risk of a commercial bank has a close relationship with its normal operation.

Keywords: commercial banks; credit risk; risk management

1. The Present Situation of Commercial Banks' Credit Risk and the Analysis of Its Causes

1.1 The Status Quo

The loan business, in China, has developed rapidly in recent years, but its operation and risk management, to a great extent, still inherits the traditional method of loan business, as a result, there exist some obvious disadvantages. In western countries loan business has already developed for several decades, it has become a very mature consumer credit business, and it is worth for our country's commercial banks to learn from these countries, especially in the prevention of the credit risk[1]. The credit risk's management system of the United States, for example, has offered guidance to our country. According to the present situation of our country, domestic commercial banks should draw lessons from risk management model of western countries, in order to prevent loan risks, by reasonable arranging the liquidity of the commercial banks' assets, establishing and improving the credit systems, focusing on the qualities and steady developing the loan asset's securitization, etc.

1.2 The internal causes of the formation of commercial banks' credit risk in China

1.2.1 The severe lacks of fundamental works of banks and credit archives

At present, the management of many commercial banks is confused, and many basic works have not been done properly, leading to a serious phenomenon that many credit archive files were lost. Because of the missing of these essential questioning and investigating reports concerning the borrowers' credits, it is difficult for banks to accurately estimate the integrity of the borrower's assets, stability of their incomes and will to repay, and, accordingly, not only increasing the difficulty of the repayment but also expanding credit risks.

1.2.2 Dysfunctional internal control mechanisms of bank credit

Establishing and perfecting internal control mechanisms of bank credit is an important way to prevent credit risk. But, Chinese banking industry has not effectively established and operated an internal control mechanism. In terms of the procedures of loan, the "three check" system has not been operated deeply, and it still remains at the first stage. There are three main arguments as will now be presented. Primarily, with respect to the key stage of risk control, investigation before lending, banks do not systematically identify the initial standards of customers, so that they cannot choose the customers through predicting cash flow; Secondly, there exist many deficiencies in the stage of loan application, examination and lending; Finally, during the stage of after-lending check, which is also a critical stage, loan officers only value the paper works and are usually vulnerable to changes, and, consequently, the

warning mechanism of loans cannot react immediately and accurately.

1.2.3 Lack of credit risk prevention and warning mechanism

In China, commercial banks' credit services are long based on manual operation. Through a step-by-step reporting process, this mechanism has already severely constrained executives on their scientific management of credit businesses[2]. Although, it is transferring from traditional credit management to be more intensive, scientific and modernized, due to the restrictions from such as management systems, techniques and individual qualities, commercial banks' works on pre risk management is relatively weak, that means the works concerning investigations before the loan, in the loan and after the loan are hardly implemented properly. For many commercial banks, the risk monitoring and warning systems have not been operated. In terms of other precautions, there are seldom seen, either, and the preventions of risks are mainly relay on such statistics as, loan risk degree, single loan ratio and non-performing loans ratio. These data indicating credit qualities are used to monitor and restrict credit behaviors of commercial banks and their branches, for the purpose of controlling commercial banks' credit quotas and credit qualities. This control, however, is only suited to constraining the extensive bank management behaviors. And it cannot be appropriately adapted to the transformation of domestic bank management pattern. At the same time, it also does not conform to the trend of the development of modern risk management of commercial banks.

1.2.4 The information asymmetry between Banks and enterprises produce the non-performing loan problem

At present about the causes of China's banking bad credit assets, mostly concentrated in the theoretical circle to consider from the system, they think that the fundamental cause of China's banking bad credit assets is institutional factors. Even it is generally believed that in a mature market economy countries commercial Banks non-performing assets belongs to the technical issues, and stated-owned enterprises' non-performing assets in the transition economy can be summed up in institutional problem. That is to say, in the implementation of market economy countries' financial market, information asymmetry is the main reason of bad bank assets, while in China there is no information asymmetry problems in financial markets or information asymmetry is not the fundamental cause of non-performing assets of Banks in China. Through the analysis, we think that institutional factors is a special reason of non-performing assets of China's banking sector, the unbalanced and asymmetric information is the common cause of banking bad credit assets domestic and foreign. Because at present our country lacks channels and effective form of communication between Banks and enterprises, once the bank loans, credit funds have into the enterprise capital circulation, enterprise master full information of the operating conditions for its own funds, but for bank produces a "grey box" effect, information about the capital operation at a disadvantage position. Some enterprises try to tamper with the accounting statements, and provide favorable project appraisal and the related data, and some even provide false material and evidence to obtain bank credit[3].

1.3 Analyzing external causes on the formation of credit risks of Chinese commercial banks

1.3.1 Improperly built and unhealthy social credit system

Thanks to the lack of credit ethics in today's society, the external environment of state-owned commercial banks risk management is not perfect, and directly generating a large number of difficulties to the credit risk management of state-owned banks. At present, although China has established an early warning system of retail business risk for major clients, the phenomenon of information asymmetry is still very common.

1.3.2 the lag of the financial system has restricted the prevention and control of bank credit risk

First of all, the market-based and financial mechanisms have developed significantly slowly. By now, the financial structure of China is not perfect. An especially prominent problem is that the direct finance merely accounts a small proportion while the indirect finance excessively relies on investment of bank financing, as a consequence, it narrows the financing channels which the less developed capital markets are used to provide for enterprises and increases the stress of commercial bank financing. Meanwhile, a huge amount of money coming from banks is invested in credit, and if a recession happens, it will be very likely to produce plenty of non-performing assets. Second, Chinese financial markets are undeveloped and lack of financial instruments. China practices a strict financial control. Separated operations and separated supervisions also hinder the expansion of bank businesses and restrict financial innovation abilities. Capital operation of commercial banks mainly focuses on loans, but the lack of effective means to resolve and transfer credit risk. Finally, financial regulations need to be enhanced. As a result of chaotic competitions among banks, enterprises open accounts in various banks and loan from various banks. Furthermore, it deprives banks of obtaining the accurate information about their clients' financial current situation, accordingly increasing the credit risk[4].

1.3.3 excessive government interventions

Recent research has proved that the local governments' intervention is one of the main causes of credit risk. Since the 1980 s, the many bank credit funds have flowed into government finances, and capitalization phenomenon has appeared frequently. So it is commercial banks that primarily take the risks from markets and investments. In China,

branches of commercial banks are established according to the administrative regions, and, consequently, banks located at different areas are subject to the local government meaning that it increases the possibility of government interventions. Administrative interferences make the autonomy of banks in loans seem impossible. To some points, banks are sacrificed for continually supporting government fiscal funds and transferring management risk from enterprises to themselves. More severely, some local governments even link the local financial development to the quantities of bank loans. Therefore, in order to achieve more over their careers, most civil servants eager to compel banks to loan more. As soon as a bank lends out, it will be like falling into a bottomless pit, because these items are usually paid by local fiscal funds, and fiscal deficits almost happened on these local governments every year. However, if the bank puts an end to the loans, it will generate harms that more than the bank can bear. Thus, the bank has no choice but delays the repayment or asks the enterprises for recapitalization. Because of the excessive interventions of local governments, there emerge a large number of irregular loans, greatly increased the bank's credit risk.

2. Comparison and Analysis of credit risk management method of Citibank

Western commercial banks have developed for a long time, and over this period, they gradually established a perfect risk management system, cultivating many qualified employees engaged on bank risk management [5]. Not only can these staff members effectively reduce the domestic bank credit risk but also provide an instructive and valuable experience to Chinese commercial banks on risk management.

2.1 The Framework of Citibank's Risk Management

The boards of Citibank have commission of venture capital and subsidiary, which is composed by independent board. Eight members work in it; they are in charge of the overall management of the company and risk management problems, monitoring the risk to the company. The administration of the risk management committee is primarily responsible for inspecting and checking the implementation of risk management. Subcommittees of market risk and credit policy administrate specific works at different levels.

2.2 Credit risk management model of Citibank

First, several concepts about credit risk management must be built.

- a. Risk prevention is better than risk management;
- b. Positive commercial promotion behaviors are better than negative risk avoidance behaviors; b. Positively setting the target market is better than passive remedying after the emerging of risks;

Second, the main contents of the credit risk management of Citibank. a. Implement positive credit management.

Analysis trends to learn its life cycle. For examples, being in the stage of growth, maturity or decline determines whether it should be refused; evaluate the products referring trade, exchange, finance, transportation, geographical factors, and risk measure and so on; achieve the expected rewards of risk management by combining analysis. b. Establish risk measurements, monitoring risks in a modern way. It includes assessing structures and trends of the Industry, analyzing management, finance and competitions, as well as accurately measuring credit risk. c. Concentrate on the target market[6]. Citigroup believes that the target market is determined by the commercial strategies of the bank. Therefore, assessments on macroeconomic and environment should base on customers, providing the appropriate products and services to customers.

2.3 Enlightenments brought by credit risk management of Citibank

Credit risk management of bank is an organic system project, and every component is a essential part of the integral system. Based on the practical cases, there always, to some extent, exist series of problems of a bad loan, rather than a single problem. Accurate and appropriate operations of every link are compensations of the former false operations.

Bank credit risk management should be moved forward to some extent.

Because the research and analysis of the competition in the market has not yet formed, Chinese banks are short of research materials and experience of judgments, causing the lack of clearly targeted customers over the expansion of business. Thus, randomness is a critical feature of this business. As a consequence, when they intend to develop new customers' relationships, they are often not ready to do it and even not clearly realize what the risks are, not even mention how to effectively prevent, curb and resolve these risks. In the competition, we do not know whether it should be attributed to successful competition or intentional termination of some banks.

The meaning of the 'industry' in the credit should be understood deeply. That because choosing the right industry partly means choosing the right groups of customers, achieving gradually and systematically development, as well as developing reasonable strategies.

Reforming assessment method to eliminate the credit risk caused by blind expansion. Affected by their system, State-owned enterprises take 'development' as their priority. Because of pressures driven by business expansions, banks are usually reluctant to ask their clients to repay the loans until some real risks emerge, and they rather believe that there is not any risk. That is the main reason why credit members of Chinese commercial banks prefer to gain information about the states of operation and finance from the enterprises other than find out by their own. In some severe cases, credit officers even believe that as long as they have mortgages or pledges, there will not be any problems. But they presumably are not considering or reluctant to consider that once risks emerge, it will be hard to reclaim the loans. Therefore, reforming management mode of state-owned enterprises is the current priority.

One is the plan of management, as will now be presented. Primarily, distinguish different situations. Next, obtain the accurate information about the practical usage of the loans. Then, clarify the usage is in long term or short term, and accordingly design different management plans for the two usages respectively. Specifically, for short-term loans, repayment plan should be made in advance. Last thing to be noticed is reassuring and following some information concerning the source of repayment, channels of the repayment and time schedules and so forth. Clear the source of, your reimbursement way, and time arrangement, and follow-up. The other is the plan of precaution. By initiating this plan, banks can react immediately when abnormal situations happen, and it allows them to be in a good position to tackle the problems.

3. Precautions of commercial bank credit risk

3.1 Staff members' capacity for work should be improved, and their quality also needs to be enhanced. In terms of the specific solutions, regular training classes aiming at credit officers organized by various Chinese commercial banks can significantly improve staff members' awareness of responsibilities and potential risks, meanwhile, enabling the banks to develop a credit culture with risk management as its core. Besides, staff should not take advantage of their power, instead, protecting the profits of enterprises and their nation, to ensure the efficiency and accuracy of each loan. In addition, with respect to management on credit approval, managers of credit department should carefully review each link, trying to reduce the possibility of bad debts.

3.2. Improve the early warning mechanism. Chinese commercial banks should introduce advanced information system of bank risk management from western countries. By effectively using credit registration system and bank credit management system, based on the existing customer sources and data, Chinese banks can establish risk management system containing operation information, applications for the loans and loan repayment. Meanwhile a mechanism on risk monitoring analysis and credit rating should be built. Afterward, a reasonable and effective early warning mechanism of risk can form.

3.3 Establish and improve a special agency for credit management

Independent approved department is necessary, because it can be helpful to carry out credit regulations, clarify obligation and work ranges of staff members from loan examination department. Set up a specialized organization united by multiple departments including asset portfolio risk analysis department, credit policy department and risk examination department, etc. And every department should fulfill their duties and communicate, cooperate as well as supervise with each other.

Independent management department is necessary. Establishing independent management department is attribute to improve the quality of examination and approval of the credit business, strengthen the responsibility of credit approval and prevent risks. The expert system of examination and approval can play an critical part In the risk control. Through the establishment of full-time loan approver system, credit business will be properly managed. The system is carried out as follow. First of all, a certain number of credit examiners or approvers are required for the authorized institutions engaging on credit business [6]. Loan approvers, should follow the Three principle, based on Chinese economic policies, laws and regulations, and credit business strategy, to inspect the economic and technological possibility of each loan. Finally, considering the potential risks and profits, they will decide whether or not to offer approvals to the loans.

Independent evaluation department is necessary. Regularly evaluations of loan risk require banks to access each loan scientifically, independently and objectively. And the assessments implemented by independent credit business are favorable to ensure the efficiency and objectivity loan risk assessment [7].

Strengthen post-loan management and guard against and dissolve the credit risk. Post-loan management is an important link in the control of credit risk, sometimes is an important means of maintaining customers, in order to effectively prevent and dissolve the credit risk, some managements of the following aspects should be prepared for the post-loan: (1) strengthen the concept of innovation and the consciousness of risk prevention. Post-loan management must be combined with the enterprise culture construction of commercial Banks under the premise of

quality and credit management personnel training and the control of professional ethics, set up the concept of dynamic management after credit, human resource strategic concept, and the benefit of post-loan management concept. At the same time improve the specialization level of management after loan and comprehensive quality is essential [8]. (2) make post-loan management procedures and content specific. Post-loan management including after regulation, credit loan, account checking, loan risk classification, customer maintenance, there is a problem loan processing and loan recovery and summary evaluation, etc. (3) to do a good job of loan risk classification, we must strengthen post-loan management. To do a good job of loan risk classification, the corresponding resolve measures to prevent and overcome risks, because of information asymmetry between Banks and enterprises on the adverse impact of the credit management, make the post-loan management standardized and institutionalized. (4) Institutionalize and intensify post-loan management work earnestly. Establish and improve a set of specific and detailed post-loan inspection measures for the administration of assessment [9]. The customer check process, information analysis, early warning and forecasting process, such as customers withdrew from the process involved in the work the overall credit assessment category, for each assessment standards and the reference for management links and factors, prompted the post-loan management consciousness deeply post-loan management, perfecting the incentive mechanism.

CONCLUSION

In recent years, the loan business has developed rapidly in China, but business operation and risk management, to some extent, still inherits the traditional operation method, and this obviously has some demerits. However, western countries' loan business has already been through several decades' development and formed a kind of relatively mature services, especially in the aspect of risk management system, which is especially worth learning by Chinese commercial banks. Although commercial banks themselves has already been aware of the existence of the risk, there are more important things, such as scientifically and reasonably evaluating the loan risks, arranging the liquidity, inspecting mortgages, strictly following the requirements of the credit risk management and standardizing management of loans. Meanwhile, the regulation departments concerned should also perfect credit laws and regulations, strength the supervisions on the commercial bank loan, increase borrowers' awareness of risks, enhance political controls and so forth.

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