

Challenges and measures faced by commercial banks under interest rate liberalization

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Abstract. the maturity of interest rate marketization marks the transformation of China's interest rate system from the traditional interest rate model to the new one. As an important participant in the reform of interest rate marketization, commercial banks are faced with many challenges, such as the decline of profit level, the substantial increase of operational risk, the increase of financial market instability, and the increase of liquidity risk. They should actively explore new business and management concepts, adopt measures to improve the prices of financial products and derivatives, introduce risk management and control mechanism, develop bank's intermediate business, and promote the development of bank's intermediate business. In order to ensure the healthy and stable development of commercial banks, we should take positive measures such as strengthening the ability of debt management, reasonably dealing with the challenge of interest rate marketization.

Keywords: Interest Rate Liberalization; Commercial Banks; Challenge; Measures

1. Foreword

Interest rate liberalization refers to the commercial banks determining the interest rate level according to the needs of capital financing and loans in the money market[1]. The interest rate liberalization reform that started in 1996 has made major changes in the overall operating environment and operation mode of China's commercial banks, and has had a profound impact on the external market environment and capital operation mode of China's commercial banks. Interest rate marketization marks the interest rate system from the traditional "eat spread" profit model to a new era of interest rate reform, reflects the commercial Banks abandon the traditional extensive management, using new lean management means, change the long-term financial system pattern, emphasize and foil the role of the market in the overall operation of the economy, promote the optimal resource allocation and capital structure adjustment, while commercial banks also need to constantly adjust and improve its capital operation mode and internal working mode, in order to better cope with the interest rate market and financial market reform opportunities and challenges. Interest rate liberalization is not only steadily promoting the reform of the interest rate market, the healthy development of the financial market, and creating more initiative in operation and development for commercial banks, but also brings a more challenging external environment and higher business risks to the development of commercial banks[2]. Based on this, China's commercial banks should effectively reduce operational risks, improve the internal management efficiency of banks, and reduce information asymmetry, in order to adapt to the impact of interest rate liberalization reform as soon as possible, and improve their operating performance.

2. Process of interest rate liberalization reform in China

In China's interest rate non-market control era, the government through macro-control interest rate control, to national key industrial departments, such as heavy industry, military industry to reduce interest rate will low funds directional input, in order to realize industrialization strategy, the rapid accumulation and development of national heavy industry original capital, but at the same time, interest rate control in promote the rapid growth of the national strategic department, disadvantages are also increasingly prominent. First of all, the national control interest rate of low interest rate reduces people's savings will, at the same time the rapid development of financial products and their derivatives, bonds, securities, futures and a series of alternative investment, reduce the source of funds, bring the development of bank capital operation difficulties, reduced operating profit, market trust

and loyalty and many other problems[3]. Second, the heavy industry sector obtained sufficient low-cost funds, commercial banks continue to reduce loan interest rates, will cause market interest rate price signal, make funds can not get reasonable allocation, greatly reduce the efficiency of capital operation, distort the overall capital structure, in the need of enterprises difficult to obtain normal financing at the same time, increase the overall operation risk of the market. For example, commercial banks face the low returns brought by low interest rates, and often refuse to make loans to small and medium-sized enterprises with high repayment risk, making it difficult for them to have sufficient funds for reasonable commercial operation, so interest rate liberalization is gradually put on the agenda.

China's interest rate liberalization reform started late. After drawing on the experience of foreign interest rate liberalization reform and combining with the actual domestic financial and economic situation, China chose the inter-bank lending interest rate as the incision of interest rate liberalization, and then gradually opened up the foreign currency interest rate market until the loan and deposit interest rates were fully liberalized. The complete liberalization of the deposit interest rate by 2015 marks that China has realized the successful reform of interest rate liberalization and realized the transformation of the interest rate from government control to market adjustment. Although there is still the problem of coexisting loan benchmark and market interest rate in China's interest rate market, which weakens the positive impact of the market interest rate on the real economy, China is also taking corresponding measures to solve the "double interest rate track", in the establishment and improvement of the quotation interest rate mechanism of the loan market, to realize the "double track and one track".

3. Challenges brought about by interest rate liberalization

3.1 Profit level of commercial banks decreased

Open of interest rate market, make commercial banks out of the government control, have more freedom and control space, also means that commercial banks need to according to their own business situation, considering their own financial ability, deposit savings ability, profitability, resource control ability, develop in line with their own healthy and stable development and competitiveness in the market deposit, loan rates, and adjust according to the interest rate of competitors[4]. In the central bank's interest rate of the money market, the overall interest rate level of commercial banks is relatively stable. To a low extent, they face problems brought by chaotic management, information asymmetry, unreasonable resource allocation and other aspects, and have a high profit level and growing income. When interest rate is marketized, the role of commercial bank changes from passive recipient of interest rate to decision makers, makers and executors of interest rate[5].

Based on the existence of many commercial Banks in the market, to improve the deposit interest rate, attract depositors for business exchanges and eventually grab profits for the purpose of commercial Banks, need to raise the deposit interest rate, in order to reduce depositors to reduce capital sources and financing ability, and make the overall operation of commercial Banks lack of capital, lack of vitality, eventually make the consequences of bank collapse. And higher deposit interest rate brings the operating cost of commercial banks, but not to improve the loan interest rate, because loans as the main means of profit, fundamentally, the confirmation of loan interest rate is the result of the market game with commercial banks, in order to attract high quality, large volume enterprise investment cooperation, commercial banks will inevitably choose to reduce the loan interest rate to improve the price advantage of commercial banks in the loan competition[6]. And the end result becomes: the increasing deposit interest rate and the loan interest rate, its essence is the result of the interest rate and competition market game, make the bank overall operating profit, this for the traditional commercial Banks, if only the loan business as the main profit business, it is difficult to ensure the higher profits and smooth operation of the bank, eventually eliminated by the market.

3.2 exacerbates the operational risks of commercial banks

3.2.1 Increase the survival difficulty of small and medium-sized commercial banks

The accelerated implementation of interest rate liberalization makes it difficult for traditional small and medium-sized commercial banks to quickly find new entry points to meet the profit growth. However, the traditional credit business and profit model are restricted by the market, competition and external environment, making it difficult to make up for the loss of traditional business income, making it more difficult to survive. Large commercial banks, with their financial advantages and scale advantages, can reduce the marginal cost, and choose to suppress other industry competitors by means of high deposit interest rate and low loan interest rate, and finally achieve monopoly[7]. Small and medium-sized commercial banks with single business and short of funding are more difficult to survive in incentive competition. At the same time, the fluctuation of interest rate promotes the flow of capital between domestic and foreign markets, intensified the uncertainty of capital, increased the capital risk in the commercial bank operation and management difficulty, make unstable capital sources, poor risk resistance ability of small and medium-sized enterprises more difficult, make it face the risk of serious losses or even bankruptcy.

3.2.2 Lead to the reverse selection of commercial banks

Due to the information asymmetry in the financial market, it is difficult for banks to accurately identify the risk level of loan target enterprises. Based on the perspective of operational risk, commercial banks will give priority to making loans to enterprises with high credit level, large operating scale and strong profit level, and to use a loan interest rate to prevent the loss of customers with low interest rate[8]. For the emerging industries with small operating scale and low profit level, it is difficult to get the corresponding loan amount, or it will face a higher loan interest rate. This makes those "risky" enterprises with high profits and risky enterprises choose to borrow more, and finally presents the phenomenon of "bad products driving out good products" in the credit market, making the overall quality of bank loans decline and the overall risk of loans rise.

3.2.3 Increase the credit risk of commercial banks

Based on high deposit interest rate, low loan interest rate, after obtaining relatively stable capital source and certain capital scale, the market interest rate rise, make the company must pay higher interest namely loan cost can obtain loans, which forces enterprises to choose to high risk, high return investment, give up a more stable operation and investment mode, in order to obtain higher operating profit, meet its demand for high profit margin. This also makes the transfer of commercial bank funds brought about by information asymmetry to high-risk enterprises willing to pay high interest rates, which increases the uncertainty and risk of bank operation, and complicates the operation system of commercial banks. When the operating performance caused by interest rate fluctuations and the unstable market declines, the bad debt rate of banks increases significantly, increasing the share of banks' bad debt reserves, and raising the credit risk of commercial banks caused by the instability of the interest rate market.

3.3 Increased the instability of the entire financial market

Commercial Banks to get rid of the traditional single credit business profit model, improve its survival opportunities and the overall market competitiveness, and seek higher profits, will choose to high risk, speculative investment, make the non-speculative capital demand supply imbalance, which makes emerging industries and enterprises with development prospects can not obtain sufficient loan line[9]. At the same time, commercial banks that make high-risk investment increase the risk and uncertainty of depositors' funds, greatly increasing the operating risk and operation difficulty of commercial banks. The high-risk areas increase the possibility of bad debts of commercial banks, reduce the credibility and customer dependence of commercial banks, and then reduce the source of their funds, improve the possibility of withdrawing funds, and finally form a vicious circle, leading to bankruptcy. Based on the inter-bank lending between commercial banks, it improves the risk of the

overall bank market. The bankruptcy of a single bank can easily cause a chain reaction and cause irreparable damage to the whole financial system.

3.4 Increase the liquidity risk

Interest rate liberalization has increased the liquidity risk of commercial banks. On the one hand, the liberalization of deposit and loan interest rates makes commercial banks be in a passive position. Although commercial banks are the makers and executors of interest rates, they are not the final decision-maker of interest rates. The final interest rate is the equilibrium state of the game between commercial banks and the interest rate market. Based on the existence of interest leverage, commercial banks will choose high interest rates to attract depositors, and lenders will choose low interest rate bank loans, two-way choice intensified the two-way flow of capital, which is not only not conducive to capital management, reduce the operation efficiency of funds, also means that commercial banks need to have sufficient cash flow to meet the high liquidity of funds, increase the difficulty of commercial bank repayment and business risk. On the other hand, interest rate liberalization has increased the cross-regional flow of funds[10]. Due to the unbalanced regional development situation and the commercial bank model in China is in the form of the total branch, the interest rate policies formulated by the same bank in different regions may be different, and the interest rate differentiation appears, which makes the non-directional transfer of funds even between the same banks.

4. Measures by commercial banks to deal with interest rate liberalization

4.1 Increase the prices of financial products and their derivatives

The basis of improving the price of financial products and their derivatives is to improve the pricing power and bargaining power of commercial banks, which needs to build a perfect reasonable pricing system and pricing system. Reasonable pricing needs to be based on full and scientific market research, and commercial banks need to take the loan amount, customer risk level, loan term as the influencing factors, study their internal experience logic and the corresponding action mechanism, and build a perfect pricing system. At the same time, different pricing methods and pricing models are adopted in different regions, and the flexible pricing method of "adapting measures to local conditions" is adopted to reduce credit risk to reduce the price of loan interest rates and increase deposit prices, so as to achieve the purpose of attracting more high-quality customers. In addition, different commercial banks need to combine their own different advantages and different market conditions, so as to grab more profits, reduce market risks and bank internal business risks, and achieve the purpose of long-term, healthy and stable development of commercial banks.

4.2 Introduce a risk control mechanism

Commercial banks facing market challenges and management risks brought by interest rate marketization should establish a reasonable and efficient risk supervision and control mechanism caused by interest rate marketization. The risk brought by interest rate liberalization is often internally associated with the national macroeconomic policy, monetary policy, price level, exchange rate level, commercial banks for the analysis and supervision of interest rate marketization trend, should establish a short, medium and long-term interest rate fluctuation model, reasonable prediction of interest rate fluctuations, reduce the operating risk brought by interest rate fluctuations, promote the performance benefit of commercial banks. At the same time, commercial banks should based on customer information[11] Establish customer portrait, based on their own business and customer groups, in-depth study of the comprehensive impact of individual, enterprise, industry, regional and other aspects, carry out efficient control of interest rate risks, and use diversified strategies to ensure the stability and safety of capital operation. The introduction of futures options, interest rate agreements and other means can also reduce the uncertainty brought by interest rate risk. At the same time, the risk response mechanism and the risk compensation mechanism should be improved, and

while making the risk control plan, we should reduce the loss caused by the risk, such as the reserve provision and other measures.

Drawing on foreign interest rate risk control means and combine with China's unique market situation, build an interest rate risk control mechanism matching with the Chinese market. To strengthen the introduction and construction of talents in the financial sector, especially in the prevention and control of risk in interest rate liberalization, we need to strengthen the construction of talent team and deeply explore the problem of interest rate risks. At the same time, the awareness of interest rate risk prevention and control should be established, and regularly carry out interest rate risk knowledge education for bank employees, so that bank personnel can improve the resolution ability and control awareness of interest rates on the basis of realizing the objective existence of interest rate risks.

4.3 Develop the intermediate business of commercial banks

Intermediate businesses, such as electronic banking, financial derivatives and financial insurance, do not need to occupy the funds of commercial banks, and the business risks are small. Under the case of declining future income and increasing non-performing loans, the non-interest income brought by intermediate business can reduce the risk of interest rate liberalization and reduce information asymmetry. Based on the development of Chinese intermediate business such as diversified and innovative business started late, There is still a large room for growth, Therefore, in the internal and external market environment pressure and transformation and upgrading and many other aspects of the considerations, Commercial banks should pay more and more attention to the role of intermediary institutions and intermediary business in the development process of banks, So that the commercial banks gradually give up the single business model, Increase the proportion of intermediate business income in the total profit income of banks, Reduce banks' reliance on traditional credit benefits, So as to improve the ability of commercial banks, the ability to change interest rates in the external market environment and risk control ability, And improve the bank's short-term, medium-term, and long-term profits, To achieve the purpose of the healthy and long-term development of commercial banks.

4.4 Strengthen the debt management capacity, and improve the business norms

Interest rate liberalization has increased the research and exploration of risks by banks, so that commercial banks have a deeper understanding of their own risk preferences. The depth of exploration affects the bank net interest margin, and the fluctuation of debt cost is the core element of the link between risk appetite and net interest margin. therefore, Banks to better improve the risk control ability, It is necessary to increase the cost of commercial banks to manage their own debt: on the one hand, commercial banks should increase their ability to evaluate customer credit rating, The target customer's financial ability, credit level, family status, income and expenditure and other aspects of the comprehensive consideration, After accurate evaluation of customer assets and accurate customer portrait depiction of customers, Improve the provision of high amount and low interest rate loans to customers with high credit level and low repayment ability, Provide loans of low amount and high interest rates for customers with low credit level and low repayment ability, And regularly check the assets of customers, Make a reasonable assessment of its repayment ability, Prevent financial credit risks in strict accordance with the norms of central banks[12]; On the other hand, commercial banks should reasonably carry out debt business to ensure the stability and health of the source of funds, but should prevent the substantial increase of operating risks caused by excessive liabilities.

5. Conclusion

Based on the background of interest rate liberalization, commercial banks should transform from the traditional single business model to the innovative and diversified business model, abandon the traditional solidified thinking model and business philosophy, and expand and develop the banking

business. Under the interest rate liberalization, commercial banks, operating risk, financial market instability, liquidity risk, should actively explore new business and business philosophy, to improve the price of financial products and derivatives, introduce risk control mechanism, develop bank intermediate business, strengthen debt management ability, reasonable response to the challenges of interest rate marketization, reduce the negative impact of interest rate marketization, improve profit level and business risk, reasonably allocate resources, improve capital utilization rate, so as to achieve the purpose of long-term healthy and stable development of commercial banks.

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