

A Study on the Loan Risks of Chinese Commercial Banks lending to Local Financing Platform

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Abstract

Based on the analysis of the formation, development and current situation of local financing platform in China, this paper analyzes the risk of China's commercial banks to local financing platform. These risks include risk of policy change, legal risk, solvency risk, liquidity risk, compliance risk, loan concentration risk, loan misappropriation risk, and so on. Further, take one Chinese city as an example, this paper analyzes the city's local financing platform for the the existing risks. Finally, from the perspective of local government financing platform and commercial banks, this paper gives some countermeasures and suggestions for the commercial banks' risk of local financing platform loan.

Keywords

China's commercial banks, financing platform, loan risks, countermeasures and suggestions.

1. The formation of China's local financing platform and the status quo

Local government financing platform, mainly refers to that in order to solve the local public infrastructure projects, local governments at all levels invest in investment funds and specifically set up an independent legal personality of the financing company. By setting up such a financing platform, local governments can solve the financing problems for urban construction, public utilities and infrastructure construction, so as to realize the market operation function of local government infrastructure construction.

In recent years, with the rapid development of urban infrastructure construction in China, the traditional financing methods cannot meet the rapid growth needs for urban infrastructure construction. In 1988, the State Council of China issued a program named "investment management system on the recent reform program", the government Investment and financing system changed from a single central investment model to the central and local co-investment model, the central and local have set up a professional investment company, the provinces, autonomous regions, municipalities and municipalities set up a local investment company one after another.

In 1994, the tax reform became an important turning point. Thanks to the shortage of local financial funds, the support of local urban infrastructure was relatively weak. Therefore, local governments at all levels began to set up legal persons who could exercise their civil liability independently in order to break through the bottleneck and legal obstacles as one financing carrier, using these financing vehicles, through the commercial bank loans or the issuance of corporate bonds, etc. To get the project construction funds.

In 2004, the State Council of China issued the Decision on the Reform of Investment System. It made an open provision for rationalizing the functions of government investment, broadening the financing channels for the project and improving the macro-control system of investment, which was equivalent to the local investment and financing companies. A wider range of financing channels had opened the door to a wider range of financing.

Data showed that, the country owned more than 3,000 investment and financing platform of different levels of government (as of August 2014), of which more than 70% were the county-level platform company, national governments at all levels of local financing platform loaned about 6 trillion in

2014, The amount of loans were twice as that of at the beginning of year 2013, of which 80% were the project loans, the vast majority of which were from the banks.

Local governments' investment and financing platform developed so rapidly, it not only stimulated domestic demand and promoted economic development, but also hidden a lot of risks, as a result, it increased the local government's financial burden, and brought a lot of risk to the banks. According to one survey data, the government financing platform debt ratio reached 94% in some places of China, it even increased to 400% in some places, while the international average range were from 80% to 120%. It can be seen that the rapid development of local credit had gone beyond the scope what the various departments can bear.

In the 2016, the People's Bank of China annual meeting also made it clear that banks should assessment reasonably and prevent local financing platform credit risk effectively, strengthen the use of bank loans management and delivery. Thus, the central government had already put it to the national level the bank that issue government investment and finance platform for the risk control. Only the local governments do a good job in projecting structure, controlling risk and other work, can they make sure that the national economy develop healthily and stably.

2. The analyzing of loan risks of China's Commercial Banks on the local financing platform

With the rapid growth of loans scale that commercial banks lend to local government financing platform, it is inseparable from the current domestic economic situation and the process of urban infrastructure construction. Firstly, under the influence of the global financial crisis, the center government introduced "4 trillion" policy as a booster, so as to stimulate domestic demand. Secondly, China's urbanization process had not been completed yet. The urban population of the United States, Europe and Japan had already accounted for range from 80% to 90% of the total population, while that of China was only 50%. The local government financing platform had generated a great influence on the whole economic operation, and its existence had already played a positive role as follows, such as stimulating domestic demand and preventing the domestic economy from slipping; promoting the local government to integrate resources and revitalize the assets; for stabilizing the domestic economy The situation has played a role in enhancing confidence; to China's banking industry has brought development opportunities; quickly launched the construction of the people's livelihood; enhanced urban competitiveness and development capacity; local government financing platform quantity and financing scale from the beginning of 2014 sharp Expansion. And data showed that the current number of official statistics has more than 3 thousand, the overall financing scale ranged from 4 to 5 trillion yuan. China Banking Regulatory Commission had already put the risk of local financing platform as the first three major risks of banking industry in year 2010.

The main body of the government financing platform includes the central government, the local government, the urban construction investment company and the commercial bank. The main body forms a competitive and changing complex environment together. The risk of the loan process mainly includes financial risks and commercial risks. In particular, the primary reason for the risk of financing platform loans include a country's macroeconomic environment, legal policy, legislation and judicial environment; platform companies' function relies on the government's financial guarantee, it would lead to the credit risk for lack of the actual main business and fixed assets; market volatility would impact the operating results of the investment company directly, and spread to the bank's business operations indirectly.

Policy change risk. Because the local financing platform is a new thing with the development of China's economy, as result, it was normal that the relevant policies were not sound and policy continuity was not stable for China's local financing platform, basically "across the river by feeling the stones", so this had a greater impact on the loan behavior of the local financing platform.

Legal Risk. Just as a legal person who is responsible for the limited liability, it is not legally clear that the responsibility of the local government on its debt due to infrastructure construction. In other

words, if the local government is unable to repay or refuse to repay such debt, there is a certain degree of uncertainty that the legal protection of the interests of creditors, which is one of the main credit existing risk that the commercial banks lend loans to the local financing platform.

Solvency risk. The ability to repay the local financing platform is one of the most important risk concerning for commercial banks to consider about lending. The reason is that the funds are partly invested in low-profit or non-profit public facilities project, it is the government's financial capacity and the stability of fiscal revenue that together determines whether these projects can repay as scheduled. It can be divided into two kinds for local financing platform to operate the project: one is without operating income or part of the operating income, such as urban roads, sewage and processing projects, such projects cannot be self-financing, financing platform repayment cannot be guaranteed, therefor it relied on local governments to repay bank loans; the other is an operating income, such as high-tech development zones and highways, the project which can be self-financing by itself, and the principal and interest of the loan are mainly repaid with the proceeds from the completion of the project.

Liquidity risk. Liquidity risk is also one of the most important risks for commercial banks to operate. According to statistics, "as of the end of 2010, China's local government debt balance had reached 10.7 trillion yuan, of which 79.0% were bank loans. In the aspect of the debt maturity period, at the end of 2014, the proportion need to repay reached up to 53.0%, and the debt period is relatively concentrated. "With the arrival of the peak of debt service, the liquidity risk of financing platform loans would gradually expose. As the infrastructure construction period and capital return time is much longer, which resulted in a large demand for funds for local financing platform loans, the longer the use of funds and the characteristics of poor performance for money realization.

Compliance risk. The risk of compliance mainly comes from two aspects: one is that the establishment of conditions exist non-compliance for the local financing platform; the other is that there is non-compliance phenomenon when commercial banks are in the issuance of loans. Firstly, the loan is insufficient due to insufficient capitalization of the project. Under the case of a serious shortage of capital and registered capital of the project, the local governments use a sum of funds in various platforms to keep their turning, when several companies registered capital or a few projects of capital, some platform companies would even have no economic benefits from the physical assets as capital, to meet the "project financing business guidelines" provisions, so as to obtain bank loans. Secondly, the information between commercial banks and local financing platform are asymmetry. Local governments generally do not provide commercial banks with their financial revenues and expenditures, local government balance sheets and financing platform loans, etc. Thus, they made it difficult for commercial banks to fully grasp the source of credit funds reimbursement.

Loan concentration risk. According to the theory of finance, asset dispersion can reduce the risks. If the loan focuses too much on an industry, region, customer or loan type, then there will be a risk of concentration of loans. Because of the rapid development of local financing platform since 2014, the concentration risk of platform loans has gradually emerged. Local financing platform loans have the characteristics of large amount and long-term, coupled with the unreasonable mechanism of internalization of commercial banks incentive, a direct result is that commercial banks prefer to finance the local financing platform. Under the guidance of this idea, the commercial banks competing for the stability of income, effective local financing platform loans, resulting in continued concentration of risks.

Loan misappropriation of risk. As the main body of borrowing, local financing platforms generally do not involve in the implementation of the project specifically; as the main body of the loans, the use of its funds are generally the relevant to local government departments. After local financing platform receive credit lines from the banks, in particular, there was no designated using of the loans. The inconsistency of the main body of the loan and the actual use of the funds made it difficult for commercial banks to monitor the specific flow of credit funds, which is prone to misappropriation of loans and is not conducive to the credit risk control of commercial banks.

3. A case Study - Risk Analysis of China's city government A's Financing Platform

According to the statistics, since 2000, city A's GDP had already maintained more than 12% growth rate for eight consecutive years. According to city A's government statistics, in 2013 city A achieved financial income of 113.296 billion yuan in full caliber, increased by 12.3% over the previous year; it also achieved local fiscal revenue 79.085 billion yuan, increased by 10.18% over the previous year. A good financial income made it sure that the city's infrastructure investment and financing business carried out successfully.

In recent years, in order to against the contradiction between rapid development of urban construction and construction of the relative shortage of funds in the construction of urban infrastructure of city A, it made great efforts in the introduction of market mechanisms, and strove to build a new urban investment and financing system, and the government transformed its role from the main mode of municipal investment to state-owned investment company as the main body gradually. Through the allocation of capital and capital market resources, multi-channel to raise social funds to speed up the urban infrastructure construction business model change.

3.1 An Overview of local investment and financing platforms

According to the principle of diversified subject, highlighting the focus and diversifying the implementation principle, under the premise and framework of the overall planning of the city, the city has established a multi-level and clear division of labor management and financing platform for urban construction projects. According to the different regions and functions of urban planning area, though the corresponding main body of the implementation of operational projects respectively, city A established a complete, comprehensive coverage of the entire urban planning area of urban construction project operation and management system. At present, the city government has already set up a number of main bodies to carry out construction and financing work, according to the main body of the debt, it could be divided into five categories: (1) key companies of municipal, the debt is mainly used for urban new areas, transport facilities and other major infrastructure construction, medium and long-term loans, repayment sources for land revenue, operating income and financial allocations; (2) municipal integrated companies. Debt is mainly used for urban industrial investment, public transport system construction, urban surrounding towns and other specialized areas, short-term loans gradually become less and long-term loans gradually become the main means for financing, repayment sources, including operating income and land income. (3) municipal specific project companies, mainly are long-term loans, repayment sources are mainly the financial allocation, allocation of land revenue and commercial real estate development and future operating income. (4) the central city of regional companies, the company which were under the control of the municipal government, the debt is mainly used for the integration of urban and rural level government to medium and long-term loans, and repayment source for land transfer income. (5) District and county investment company, whose debt is mainly used for the integration of urban and rural government-level construction, mainly are long-term loans, repayment sources are land transferring income.

3.2 City A's banks competition on the financing platforms

3.2.1 Core investment and financing platform competition among industry of city-level intensified

As the banks began to tilt their credit resources to the government credit customers and key projects, such customers generally existed a large increase in the amount of credit situation, resulting in increasing the competition among the industry, loan pricing also started to cut. Branches in the credit line and the proportion of credit had a substantial decline, therefore the status of cooperation also been affected, and even faced the risk of marginalization.

3.2.2 The battlefield of competition among the industry began to transfer to the quality of customers outside the market of core investment and financing platform

Effected by the increasingly fierce competition of the municipal core investment and financing platform in the industry, the city's core investment and financing platform credit line was greatly saturated, there were often a large number of credit lines cannot be idle lazy. The commercial banks have to transformed to high-quality customers outside of marketing to the municipal core investment and financing platform. In 2013 and 2014, the local governments' financing platform for bank loans have increased significantly. Statistics showed that some of the financing platform for the total financing reached to 86 billion yuan at the end of 2014, accounting for 65% of all the fiscal revenue in 2014.

3.3 The existence of the risk for city A investment and financing platform

City A's government investment and financing platform mode of operation was mainly that government designated a piece of land according to the city's planning by the project company remediation. Bank loans should be paid in advance for part of the construction funds until the land was completed and the market is mature. The land auction income (including land transfer) and the reported construction fee were a source of repayment, that is, using land to exchange funds and using space to exchange time. In this model, the main risks included five aspects: the first was the convergence of loans, which was not conducive to commercial banks to strengthen credit management on the lack of initiative and forward marketing and marketing, and it was not conducive to the long-term development of commercial banks as well. In order to obtain the loan right of infrastructure projects, some commercial banks relaxed credit standards to competing each other, relaxed loan management and supervision, which easily formed a vicious competition, distorted the normal relationship between banks and firms, affected the bank's financial security.

The second was the potential policy of risk. Such as price regulation reform, changes in standard for fees, "charges to tax ", may affect the source of the loans for some of the infrastructure loans .The letter of repayment promised which was not authorized by the People's Congress , provided security by Ministry of Finance and other state administrative departments , the procedures which provided guarantees were unlawful and the principal qualification of the guarantor was illegal ,thus it would affect the preservation of the credit assets.

The third was the overall liquidity risk of the potential banking industry. Thanks to the fact that the loans was too concentrated on the infrastructure and real estate, the proportion of long-term loans in commercial banks was seriously exceeded, and the ratio of deposit and loan was imbalanced, which was the potential liquidity risk for commercial banks as a whole.

Fourthly, the potential risk associated with the potential real estate market. Because the source of the infrastructure project with the background of government credit had a direct relationship with the operating income of the state-owned land, if the real estate market was sluggish, it would inevitably cause the interruption of the government-owned land operation chain, the government project repayment funds would have no landing.

Fifthly, as the local financing platform loan period from short to long overdue, which made most of the repayment time concentrated in the next 3 to 5 years or so, and it would bring greater pressure on the local government as a result.

4. Countermeasures and suggestions for loan risks of China's commercial banks on the local financing platform

4.1 Avoid their own risks based on the local government financing platform

4.1.1 Resolving the stock loans.

To resolve the local financing platform stock loan risk, the government should follow the principles which were in accordance with "policy unchanged, deepen the rectification, prudent exit, emphasis on increasing the letter", adhere to long-term mechanism of resolving the immediate risk and construction risk control, adhere to the combination of disposal of stock risk and control new loans,

adhere to the combination of strengthening the classification management and controlling the exit risk. Taking slowing down the risk as the goal, reducing the old control as the focus, improving the cash flow coverage as the starting point, so as to effectively prevent the platform loan risk.

It required each loan corresponding to the specific project for the stock of loans to "unpacking, re-established". To follow up to the project, especially the project capital flow situation, it needs implement the source of repayment. To control the stock platform loan, banks should implement the "conditional period adjustment" principle in accordance with the current regulatory policy of the CBRC, loaning to the local financing platforms which meet the conditions, allowing the appropriate extension of the repayment period or extension time if they are been approved. This period of adjustment is only a short-term adjustment of the risk for commercial banks, which is not from the real solution. In order to meet the local financing platforms', the duration adjustment of stock loans, commercial banks can claim a reasonable "price" for compensation, such as increasing in lending rates appropriately or increasing the collateral and so on.

4.1.2 Establish Local Governments' Credit Evaluation System.

The credit rating is a judgment for the solvency of the rating body and the willingness to pay the debt. For the general business, the main role is the solvency, because the general business is difficult to bear the consequences of default, thus the cost of default is high. Although the local government investment and financing platform is a legal entity, but the source of its debts are closely related to local finance, corporate credit and local government credit. Therefore, in addition to study the credit level of the company's own financial situation, the more important research object is the local government credit and financial security for the study the local governments infrastructure investment and financing platforms.

4.1.3 Accelerating the construction of local government financing management and supervision system.

It is proposed that the local governments finance departments set up local government financing supervision and management center as soon as possible to strengthen the management of credit funds, unify arrangements, use the dispatching credit funds. At the same time, risk monitoring system should also be established for the financing platform company. In accordance with national laws and regulations and modern enterprise financial system, the local government financing platform for the company's internal risk control system should be established as soon as possible, so as to use funds rationally, control financing risks, strict credit fund audit, have all-round management supervision and supervise risks of the existence with every good construction funds in the whole process.

4.1.4 Clear government functions and optimize government agencies.

It is proposed to further rationalize the power of all levels of government, in accordance with the principle of matching the authority rights and financial rights and the principle of balanced development, to further clarify the positioning of government affairs at all levels, improve work efficiency, enhance local government financing capacity, and strength local financing platform. As the owner of the state-owned assets, District and county governments should actively learn from the field, the city's advanced experience, the establishment of local government state-owned assets management department,

4.1.5 Co-ordinate the development and construction and financing, to achieve input and income interaction.

To continue to increase the development of construction and financing of the combination, use expected benefits to achieve sustainable financing. In the development and construction of financing projects, we should focus on the rational use of stock and incremental land reserves, and finance the land to be developed as collateral through the overall packaging to achieve sustainable financing.

4.2 The point of view of commercial banks to strengthen the risk management of loans

4.2.1 choose high-quality local financing platform customers.

In the process of financing the local financing platform, commercial banks should be in accordance with the principles of commercialization and differentiation, in accordance with the provisions of the

national loan standards and loan conditions, narrowing access condition and loan approval, selecting high-quality local financing platform customers, to maximize the benefits of commercial banks and minimize the risk. Focus on the following factors: industrial policy, regional selection, project capital implementation, solvency.

4.2.2 Implement legitimate and effective pledge.

In order to ensure the quality of loans, commercial banks should reduce credit loans, and mainly use security loans to resolve the risk. Under the conditions to guarantee, banks should strive for real estate or construction in progress and other physical assets of the mortgage, implement the proceeds of pledge for the proceeds projects. In business practice, the collateral is subject to the common assessment, guarantee and the intermediary companies and banks, such as the asset appraisal company. Collateral ratio must be in accordance with the provisions of the Guarantee Act, and commercial banks may reduce the mortgage ratio according to the specific project.

4.2.3 Choose syndicated loan among the commercial banks.

A local financing platform is often associated with a number of commercial banks who have business relations, the banks give a larger credit line to the local financing platform. Due to the opaque platform information, coupled with commercial banks have limited access to platform information channels, resulting in that banks are unable to grasp the financing Platform real specific amount of debt. Based on the confidentiality of customer information and the competitiveness of the industry, there is no effective communication and cooperation mechanism among commercial banks. Different banks should strengthen communication and contact with each other, establish a good partnership, make efforts to form a resource in sharing risk prevention, information exchange and other aspects, form a win-win situation in the common risk, mutual information of local financing platforms, so as to minimize the risk of information asymmetry and achieve information complement each other to jointly prevent local financing platform credit risk.

4.2.4 Establish one risk assessment system for local financing platform.

In the case where the external rating is limited and the internal rating system of the commercial bank is not compatible with the development of the local financing platform, allowing that the local financing platform business plays an important role in the operation of commercial banks, it is suggested that the commercial banks should establish a special financing platform for commercial banks as soon as possible. Due to the particularity of the local financing platform and the mode of debt repayment in addition to research platforms risk assessment management ability and financial strength, we should also pay attention to the change of the national policy, the legal obstacle to the debt security, the financial strength of the local government and local government credit and other key risk factors that could lead to a debt crisis on the platform.

5. Conclusion

After analyzing the formation and development of local financing platform in China, this paper analyzes the risk of local commercial banks' financing to local financing platform. These risks include risk of policy change, legal risk, solvency risk, liquidity risk, compliance risk, loan concentration risk, loan misappropriation risk, and so on. Taking China's city A as an example, this paper further analyzes the risk of its financing platform, including the lack of initiative and forward-looking development of loan management, which is not conducive to the long-term development of commercial banks, potential policy risks, and potential banking, the overall liquidity risk, the potential risk associated with the potential real estate market, the local financing platform loan term from short to long term overdue. This paper argues that we should avoid risk from the local government financing platform and strengthen the loan risk management from the perspective of commercial banks.

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