

## Study on the External Causes and Preventive Measures of Rural Cooperative Financial Risks in China

Zejiang Zhou<sup>1,a</sup>, Yabing Ren<sup>1,b</sup>

<sup>1</sup>School of Economics, Anhui University of Finance and Economics, China.

<sup>a</sup>aczzj123456@163.com, <sup>b</sup>1034099166@qq.com

### Abstract

As an important part of China's financial system, rural cooperative finance is rapidly transiting from traditional financial institutions to modern financial institutions, and its business is increasingly commercial. Therefore, it is very urgent and important to strengthen the risk management of rural cooperative financial institutions. This paper points out that the main external causes of rural cooperative financial risks in China are poor credit environment, imperfect laws and regulations, imperfect security system, government's misplaced behavior and adverse policies, and imperfect external supervision mechanism, and puts forward targeted risk prevention measures.

### Keywords

Rural cooperative finance, Risk management, Preventive measures.

### 1. Introduction

With the development of modern financial market, financial institutions are changing from traditional capital financing institutions to institutions that produce financial products and provide financial services with the purpose of profit-making. Their operation is bound to face various forms of risks, such as liquidity risk, credit risk, market risk, operational risk and credit risk, which urgently requires financial institutions to have perfect risk prevention mechanism and strong risk handling ability, otherwise, it will not only affect its own survival and development, but also may endanger the overall situation of economic development and social stability. As an important part of China's financial system, rural cooperative finance is rapidly transiting from traditional financial institutions to modern financial institutions, and its business is increasingly commercial. Therefore, it is very urgent and important to strengthen the risk management of rural cooperative financial institutions. In addition to the internal reasons, there are also many external reasons. This paper analyzes the external causes of rural cooperative financial risks in China, and puts forward the corresponding risk prevention measures.

### 2. The External Causes of Rural Cooperative Financial Risks in China

#### 2.1 Poor rural credit environment

The rural credit environment is the foundation of the rural cooperative financial environment and the prerequisite for the survival and development of the rural cooperative finance. At present, the poor credit environment in rural areas in terms of financial lending mainly includes the following aspects: (1) The behavior of peasants' debt and debt. Farmers have always been the main loan object of rural credit cooperatives, while some farmers have weak credit concept and poor repayment awareness, and they are in debt or debt dragging behavior after getting loans from rural credit cooperatives. Some farmers have the idea that they will not repay their debts from the beginning of the loan. They try to borrow money from the credit union, but they have no plan to repay it. When the repayment deadline is up, these borrowers will not take the initiative to repay. When the credit management personnel of rural credit cooperatives go to collect loans, they find that some borrowers have good housing conditions, complete appliances and full repayment ability, but they rely on the reasons of heavy family burden, no source of economic income and so on. However, some loan farmers, whose

economic conditions have not improved, are even more reluctant to accept loans and are very resistant to the credit managers who go to collect loans. Debt dragging is also one of the main forms of farmers' lack of credit. Some farmers who borrowed from the credit union said that they didn't intend to repay the loan after the repayment deadline, but they just helped others with the loan and others didn't repay it, resulting in long-term default of the loan. In this kind of loan group, the capital dispute between the nominal borrower and the actual user makes the credit union loan enter into the vortex of "triangle debt", thus forming the phenomenon of indirect default on loan [1].

(2) Evasion of debts by township enterprises. Some township enterprises have weak credit awareness, trying to escape the debts of credit cooperatives, which makes credit cooperatives lose a lot of credit assets, weaken their support for rural economic development, and bring great financial risks to credit cooperatives. There are various forms of township enterprises escaping from the debts of credit cooperatives, mainly including the following typical forms. One is to take the way of shutdown, bankruptcy or bankruptcy to escape and abandon debts. The second is to take the way of merger or division to evade debts. The third is to evade debts by leasing and contracting.

## 2.2 Imperfect laws and regulations

After years of reform and construction, China's laws and regulations on the management of financial institutions are becoming more and more perfect, so as to ensure the healthy development of the financial market. However, only some documents have been issued on the risk management of rural cooperative financial institutions, while the laws and regulations on the management of rural cooperative financial institutions are seriously lagging behind, and the laws and regulations on the management of rural cooperative financial institutions are missing. Sound has become an important external cause of rural cooperative financial risks in China. Since 2003, China has issued a series of documents on risk supervision of rural cooperative financial institutions. The methods of risk supervision of rural cooperative financial institutions have been institutionalized, programmed and standardized. The main provisions of these documents are Interim Provisions on the Management of Rural Commercial Banks, Interim Provisions on the Management of Rural Cooperative Banks, Classification of Credit Asset Risks of Rural Cooperative Financial Institutions, Guidance on Risk Classification of Non Credit Assets of Rural Cooperative Financial Institutions, etc. From the above normative documents, it can be seen that in recent years, the CBRC and the people's Bank of China have formulated and implemented some regulations and rules, and rural credit cooperatives have also formulated some articles of association, but the rural cooperative financial institutions lack the basic guarantee in terms of system and law, which makes the development of rural cooperative finance face higher risks [2].

## 2.3 Imperfect security system

Developed countries ensure the healthy operation of rural cooperative financial institutions through perfect security systems, such as agricultural insurance system and deposit and loan insurance system. When there is a natural disaster, the agricultural income is greatly reduced, and farmers are unable to repay their loans, the agricultural insurance system will be used to protect the rural cooperative financial institutions from serious losses; when the cooperative financial institutions in memory are not well managed and have losses, the deposit and loan insurance system will be used to protect the depositors from serious losses. At present, there is still a lack of a sound agricultural insurance system and a formal deposit insurance system in China. When agricultural production is reduced, farmers are unable to repay loans, or rural cooperative financial institutions suffer losses due to their own poor operation, they are all borne by themselves. At the same time, the interests of depositors are difficult to be effectively guaranteed, so the operation of rural cooperative financial institutions is facing higher risks. In the developed countries with sound safeguard system, if the rural cooperative financial institutions still cannot operate normally after the safeguard system is put into operation, some credit cooperatives with very serious losses will be bankrupt according to the market law of survival of the fittest. Make the managers of rural cooperative financial institutions face greater pressure, so as to improve the level of operation and management. However, due to the lack of a sound security system

in China, the rural cooperative financial institutions are seriously insolvent and unable to go bankrupt. For their continued operation, the government has to use financial funds to support the rural cooperative financial institutions [3]. As a result, the managers of rural cooperative financial institutions may be lazy without bankruptcy pressure, or apply funds to high-income and high-risk areas, which makes the operation of rural cooperative financial institutions face greater risks.

#### **2.4 Government's misbehavior and adverse policies**

(1) Inadequate government support and offside management. In order to support the healthy development of rural economy, the government requires the main service object of rural cooperative financial institutions to be "agriculture, rural areas and farmers", and stipulates the proportion of loans to "agriculture, rural areas and farmers", so that the rural cooperative financial institutions can assume part of the responsibility of policy finance, but there is no preferential tax, and no corresponding financial support. In terms of deposit reserve rate and reserve rate, the government requires commercial funds. Financial integration, which leads to the aggravation of the burden of operation, the deterioration of operation, the increase of risk level, and the reduction of the function of serving "agriculture, rural areas and farmers". While the support is not in place, the government's intervention in rural cooperative financial institutions is very strong, forming offside management, thus increasing the degree of risk. With the improvement of the property right system and management system, the rural cooperative financial institutions take the efficiency, security and liquidity as the operation principle, and gradually implement independent accounting, independent operation, self financing and self risk. The government's function is to make macro-control on the rural cooperative financial institutions by formulating macro policies. At present, some local governments are still the main body and center of rural cooperative financial institutions' fund allocation, and intervene in the operation and management of rural cooperative financial institutions. These government behaviors pay more attention to political purpose or local social benefits, ignoring economic benefits and resource allocation functions [4]. The government's Offside management of rural cooperative financial institutions will inevitably lead to an increase in the risk of rural cooperative financial institutions.

(2) Adverse policy environment. For a long time, rural credit cooperatives have played a major role in supporting China's rural economy. After the transformation, the business of rural cooperative banks and rural commercial banks will mainly serve "agriculture, rural areas and farmers". We should give policy support to rural cooperative financial institutions to ensure their healthy development in accordance with the national common practice of cooperative financial development. However, it is in a disadvantageous policy environment, which is not conducive to its development of tax policy and fiscal policy. Its adverse policy environment is mainly reflected in the following two aspects: first, the adverse impact of tax policy. Two is the adverse effect of financial support policy.

#### **2.5 Imperfect external supervision mechanism**

Perfect external supervision mechanism is an important mechanism to regulate the operation and management of financial institutions, control and prevent financial risks. However, the external supervision mechanism of rural cooperative financial institutions in China is not perfect, which is mainly reflected in the function of the supervision subjects is not coordinated, the supervision of senior managers is only formality, the punishment is not enough, the supervision method is not appropriate, and the index data needed for supervision is difficult to obtain [5].

### **3. Preventive Measures for Rural Cooperative Financial Risks in China**

Based on the experience of cooperative financial risk management in developed countries and the risk prevention measures of general commercial banks, and according to the actual operation of rural cooperative financial institutions and relevant laws and regulations in China, the following measures are proposed for the external causes of rural cooperative financial risks in China, so as to improve the risk prevention and control ability of rural cooperative financial institutions.

### 3.1 Measures to improve rural credit environment

It is a systematic project to improve the credit environment in rural areas and enhance the credit awareness of farmers and township enterprises. First, actively promote the construction of rural credit system. Second, strengthen the training of credit personnel in rural cooperative financial institutions. Third, we should strengthen the education of honesty and credit, and enhance the farmers' concept of credit. The fourth is to establish a system of constraint on dishonest customers.

### 3.2 Improve laws and regulations

To improve the laws and regulations of rural cooperative finance from the following aspects:

(1) The rural cooperative finance law was promulgated. Cooperative finance law is a normative legal document about cooperative financial activities formulated by the state's highest authority and its permanent organs, which has the highest effect in the legal norms of cooperative finance. From the perspective of the development of the world's cooperative finance, the successful countries of the cooperative finance must all be the countries with relatively perfect legal system construction of the cooperative finance. In order to ensure the healthy development of rural cooperative finance, the state should formulate the rural cooperative finance law as soon as possible.

(2) Improve the implementation mechanism of financial laws. Due to the improper role of the government in the whole rural financial system, the current behavior of the government in the management mode of rural cooperative financial institutions is out of line. Therefore, we should focus on the whole rural financial system, and lay the legal foundation to control the government's improper intervention from the source.

(3) Formulate targeted laws and regulations. Rural cooperative financial institutions belong to collective owned enterprises in terms of legal attribute, which requires the management of rural cooperative financial institutions in the way of modern enterprise system. However, due to various historical and practical reasons, many rural cooperative financial institutions lack the necessary understanding of this point. Some rural cooperative financial institutions are also used to personnel management by some outdated administrative means rather than effective legal means. Therefore, laws and regulations on personnel management should be formulated as soon as possible.

(4) Increase legal training. The internal staff of rural cooperative financial institutions, especially auditors, credit officers and clearing officers, shall be provided with practical, effective and targeted legal business training, so that they can understand the law and understand the law more consciously and freely, avoid and reduce the occurrence of adverse legal consequences to the greatest extent, and effectively reduce the risks in specific operations, so as to make all kinds of rural cooperative financial services. The work has been brought into the track of rule of law and standardization.

### 3.3 Establish and improve the security system

Draw lessons from the security system of rural cooperative financial institutions in developed countries, establish and improve the security system of rural cooperative financial institutions in China.

(1) Establish agricultural insurance system. Rural cooperative financial institutions mainly serve agriculture and provide credit funds to agriculture before, during and after production. At present, China's agriculture is still a weak industry, vulnerable to the impact of the natural environment, rural cooperative financial institutions credit fund repayment risk is greater. In recent years, China is carrying out the adjustment of agricultural industrial structure, and emerging market entities such as "large contractors" and "Industrialization Bases" have emerged one after another. These market economic entities need a large amount of credit funds, but the value of their collateral is difficult to estimate, and the mortgage system is difficult to implement. When natural disasters occur, rural cooperative financial institutions will suffer huge losses. Therefore, according to the characteristics of agricultural production and the actual needs of farmers' credit, the government should establish an agricultural insurance system as soon as possible to disperse the risks faced by agricultural production,

so as to ensure the safety of loan funds of rural cooperative financial institutions and improve the enthusiasm of rural cooperative financial institutions in serving agricultural production.

(2) Establish deposit insurance system. In China, rural cooperative financial institutions usually have small assets. Once there is a liquidity storm, the ability of self-help is very poor, and it is easy to fall into bankruptcy, which brings financial losses to farmers and township enterprises. Therefore, the deposit insurance system should be established according to the deposit characteristics of rural cooperative financial institutions. When there is a capital crisis due to the mismanagement of the cooperative financial institutions in memory, the deposit insurance system should be used to guarantee the depositors to pay off their deposits, improve the credit rating of the cooperative financial institutions in rural areas, and ensure the safety of the rural financial system. The deposit insurance system is mainly to establish deposit insurance institutions, which can be regional, national, policy and commercial.

(3) We will improve the mortgage guarantee system and establish a credit guarantee fund. When rural cooperative financial institutions grant loans to farmers and township enterprises, they should increase the proportion of mortgage and guarantee loans in the total credit funds, and standardize the mortgage and guarantee procedures. When handling the mortgage loan, it is necessary to correctly evaluate the value of the collateral, carefully verify the ownership and liquidity of the collateral, sign the mortgage contract according to law, and effectively manage the collateral to prevent serious loss of its value. It is an effective way to make up for the loan risk to carry out loan guarantee mortgage. When handling secured loans, it is necessary to carefully verify the repayment ability and credit level of the guarantor, and sign a guarantee contract according to law. In the implementation of secured mortgage loan, if the borrower is unable to pay off the debt or intentionally evades the debt, the loss of the rural cooperative financial institution that issued the loan will be effectively controlled. In addition, in order to prevent credit risk, credit guarantee fund can be established. The local government, rural cooperative financial institutions and local township enterprises are responsible for the establishment of a new guarantee fund, which is used to guarantee loans for farmers who are unable to handle loans due to the lack of appropriate collateral. When farmers are unable to repay the insurance, the guarantee fund is used to compensate the rural cooperative financial institutions, so as to effectively reduce the credit risk [6].

(4) Establish credit risk compensation system. Establish the credit risk compensation system of rural cooperative financial institutions, change the way of credit risk compensation from government direct compensation to indirect compensation, promote rural cooperative financial institutions to understand the market rules more clearly, act according to the market rules, make correct investment decisions, strengthen risk management, and effectively reduce the risk. Specifically speaking, the credit risk compensation system makes the rural cooperative financial institutions strengthen risk management in the following aspects: first, to promote the rural cooperative financial institutions to correct the concept of operation and establish the concept of business expansion with capital as the core. The second is to strengthen management, improve economic efficiency, speed up the pace of write off loans, and speed up the process of resolving credit risks. Third, we need to change the way we propose reserves, from the way we draw the difference between the bad debt reserves to the way we legally draw the bad debt reserves every year, so as to enhance our ability to mitigate risks.

### **3.4 Standardize government behavior and create a good policy environment**

In view of the government's excessive interference and offside behavior in the operation and management of rural cooperative financial institutions, this paper puts forward specific measures to regulate the government's behavior. In view of the unfavorable policy environment faced by the rural cooperative financial institutions in China, we should start with two macro-economic policies: fiscal policy and monetary policy to create a good policy environment. First, regulate government behavior. The excessive intervention and offside behavior of the government make the management level of rural cooperative financial institutions unable to improve, the operation status difficult to improve, and the risk level increased. Therefore, we should regulate the government's behavior as soon as

possible to increase the independence of rural cooperative financial institutions. This requires the government to make the following changes: first, change the financial awareness. The second is to change the role of functions. Second, create a good policy environment. The government should give full consideration to the special purpose of rural cooperative financial institutions to serve "agriculture, rural areas and farmers", and create a good environment for the development of rural cooperative financial institutions in terms of fiscal policy and currency, starting from the overall situation of supporting rural economic development. First, we should formulate preferential tax policies. Secondly, preferential monetary policy should be formulated.

### 3.5 Improve the external supervision mechanism

Improve the external supervision mechanism from the following aspects:

(1) Coordinate the functions of different regulatory bodies. The functions of different supervision subjects of rural cooperative financial institutions are not coordinated, which will inevitably affect the supervision effect. Therefore, the functions of different supervision subjects should be coordinated as soon as possible. First, the people's Bank of China should strengthen supervision. Secondly, give full play to the regulatory role of CBRC. Finally, change the supervision mode of Provincial Credit Union.

(2) We will strengthen supervision over senior managers and increase penalties. Gradually establish and improve the senior management information base and senior management market, and promote the transformation of senior management selection mechanism. The supervision of senior management personnel cannot stay in the one-time review before taking office. After taking office, senior management personnel shall be continuously and dynamically supervised, and supervision information shall be recorded in time, such as operation and management performance assessment data and results, major risk issues, violations and corrections. And establish and improve the reporting system and supervision and reporting system for senior managers' violations, major family matters, etc. At the same time, we will increase the penalties for violations of laws and regulations.

(3) Improve the way of supervision. The on-site inspection and off-site supervision are closely related banking supervision methods. The on-site inspection is to discover and prevent risks from an empirical perspective, while the off-site supervision embodies the supervision principle of risk monitoring and early warning. Through on-site inspection of rural cooperative financial institutions, we can have a deep and detailed understanding of their internal control and management level, business operation compliance, asset and liability status, liquidity, safety and efficiency, and can find some hidden problems in time, which are difficult to understand from the financial statements and business data. Off site supervision is an important way of rural cooperative financial institutions supervision, which should be improved in the following aspects.

(4) Establish regulatory information platform. In order to reduce the information asymmetry between regulators and regulatory objects, and effectively transfer regulatory information between different regulatory departments, the information databases of each competent department of rural cooperative finance should be connected to build a unified regulatory information platform. The supervision information platform of rural cooperative financial institutions is jointly designed and established by the people's Bank of China, China Banking Regulatory Commission, China Securities Regulatory Commission and China Insurance Regulatory Commission.

## 4. Conclusions

The main external causes of rural cooperative financial risks in China are as follows: poor rural credit environment, imperfect laws and regulations, imperfect security system, government's misplaced behavior and adverse policies, and imperfect external supervision mechanism. Based on the experience of cooperative financial risk management in developed countries and the risk prevention measures of general commercial banks, and according to the actual operation of rural cooperative financial institutions and relevant laws and regulations in China, the following measures are proposed for the external causes of rural cooperative financial risks in China, so as to improve the risk

prevention and control ability of rural cooperative financial institutions. First, measures to improve the rural credit environment; second, improve laws and regulations; third, establish and improve the security system; fourth, standardize government behavior and create a good policy environment; fifth, improve the external supervision mechanism.

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