Impact of Strengthened Financial Regulation on Commercial Banks' Asset Risk: A Case Study of China CITIC Bank

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Abstract. As an integral part of China's economic system, the financial market plays a crucial role. In recent years, China has attached increasing importance to the financial market and intensified efforts to improve financial regulatory systems, with a particular emphasis on banking supervision. Banks, as vital components of the financial market, have a significant impact on the stability of the entire financial system due to their level of risk exposure. In order to better explore the changes in bank asset risk under the trend of strengthened regulation, this paper conducts a case study on China CITIC Bank. The case of China CITIC Bank being penalized serves to illustrate the inherent risks in the assets of China CITIC Bank. Furthermore, through this penalty, China has sent a signal to financial institutions to strengthen regulation, thereby compelling banking institutions to enhance their risk management capabilities. Under the trend of intensified regulation, it can be inferred that central oversight of banking institutions will gradually strengthen.

Keywords: Financial regulation; Commercial banks; Asset management; Finance.

1. Introduction

As an essential component of China's economic system, the financial market plays a crucial role in stabilizing economic development and serving the real economy. Since 2021, commercial banks in China have continued to deepen reforms, leading to continuous improvement in asset quality, further consolidation of risk coverage capabilities, and a recovery and increase in profitability. Meanwhile, adhering to the concept of "balancing development and security," the government has issued a series of regulatory policies targeting commercial banks, particularly exemplified by the "Classification Method for Financial Asset Risks of Commercial Banks" issued on February 11, 2023 (hereinafter referred to as the "Classification Method") and the "Capital Management Measures for Commercial Banks" issued on October 26, which are most representative. The management measures explicitly state that "commercial bank capital should withstand the risks they face, including individual risks and systemic risks," indicating strengthened risk regulation on commercial banks in China. As crucial components of the financial system, the risk-taking level of commercial banks has a significant impact on the stability of the entire financial system. Asset risk of banks is a vital factor influencing the asset quality of banks and has an important impact on banking risk. In recent years, the country's emphasis on the safety of the capital market has continued to increase, financial regulation has been strengthened, and the financial market has entered an era of "strict supervision." To better explore the changes in bank capital risk during the era of intensified financial regulation, this paper takes China CITIC Bank as an example to analyze its reasons in-depth and the reflections and inspirations arising from it.

2. Literature Review

2.1. Asset Risks and Influencing Factors of Commercial Banks

The assets of commercial banks refer to resources formed by past transactions or events, owned or controlled by commercial banks, and expected to bring economic benefits to commercial banks, including credit assets, bond investments, cash assets, etc., with loans and investments being the most significant. Generally, the security of bank assets refers to tangible and intangible asset security. Uncertainty in economic policies and central bank monetary policy regulation will impact the asset risk of commercial banks. In times of uncertain economic policies, commercial banks adjust their asset structure to achieve risk avoidance [1]. Studies have shown that financial technology also influences the behavior of commercial banks in adjusting asset structure, thereby affecting bank assets [2]. The development of financial technology has driven the market-oriented interest rates of deposits, reducing the proportion of household deposits and altering the liability structure of banks, thereby increasing banks' liability costs. Consequently, to compensate for losses, commercial banks tend to choose higher-risk assets, thereby increasing their risk-taking behavior.

2.2. Development of China's Banking Regulatory System

China's financial regulatory system has undergone a long process of development. The 2008 financial crisis caused significant impacts on the global economy and financial system, prompting countries worldwide to recognize more clearly the positive role of regulation in preventing and controlling financial risks. At the beginning of the 21st century, China established a regulatory pattern of "separation of monetary policy and financial supervision, separate supervision of banking, securities, and insurance industries." In the past, China lacked clear laws, regulations, or central guidance to define the responsibilities and boundaries of local financial regulatory agencies [3]. Consequently, there were some prominent problems in financial regulation. Under the background of segmented regulation in the financial industry, due to differences in regulatory objectives among different institutions, there often existed different standards, regulations, and enforcement approaches, leading to regulatory conflicts, vacuums, and redundancies [4]. Song Yunling et al. pointed out that China's regulatory departments exhibited problems such as selective punishment and low penalty intensity, resulting in less than ideal-regulatory efficiency and effectiveness [5]. However, China's regulatory agencies have been continuously improving regulatory rules and regulations and increasing penalty intensity. In 2016, the China Banking Regulatory Commission punished a total of 631 institutions, with a total penalty amount of 270 million yuan, and punished 422 financial practitioners. In 2017, the intensity of punishment in the banking supervision system significantly increased, with a total of 1877 institutions punished, 1547 responsible individuals, and a total penalty amount of 2.932 billion yuan. In 2018, the banking supervision system punished more than 1900 institutions, 2044 responsible individuals, and a total penalty amount of nearly 2.156 billion yuan. Subsequently, strict supervision and risk prevention have become new trends in international financial industry regulation. On November 17, 2017, the People's Bank of China, the China Banking Regulatory Commission, the China Securities Regulatory Commission, the China Insurance Regulatory Commission, and the State Administration of Foreign Exchange jointly issued the "Guiding Opinions on Regulating the Asset Management Business of Financial Institutions (Draft for Solicitation of Comments)," aiming to address long-standing issues in the asset management industry by setting unified standards and regulations, marking the first unified regulatory policy for China's asset management industry. Since then, China's financial regulatory system has continued to develop and improve.

2.3. The Influence of Financial Regulatory System on Bank Behavior

Following the outbreak of financial crises, scholars have begun to pay attention to and rethink the positive role of regulation in bank stability and risk prevention. In recent years, China's economy has been in the process of preventing and resolving major risks, shifting from supervision to strict regulation [6]. There have been divergent views on the impact of financial regulation on banks, especially on their risk conditions. Many studies have pointed out that regulation can effectively enhance bank stability and reduce bank risks. Stigler believes that powerful regulators can timely correct risky behaviors of fragile institutions and improve the overall stability of the banking system [7]. In terms of bank capital regulation, Repullo verified the role of capital regulation by constructing a dynamic theoretical model of non-perfect competition in banks, finding that capital requirement policies can effectively prevent banks from taking on excessive risks [8]. Wu Junlin's research shows that macro-prudential policies such as higher capital regulation pressure and liquidity requirements can further improve financial stability [9]. Delis et al. argue that regulatory punishment measures can effectively deter non-compliant banks, forcing them to adjust risk strategies and effectively reduce their risk exposure [10]. Moreover, when increasing regulatory punishment pressure and regulatory warning pressure, banks tend to invest in low-risk assets [11]. Additionally, while increasing capital, banks also actively take measures to reduce the proportion of risky assets [12]. However, some scholars and experts have questioned the effectiveness of regulatory punishment. Köster and Pelster believe that bank managers are unlikely to change their risk-taking levels due to penalties because, under normal circumstances, the profits banks derive from risky behaviors far outweigh the fines imposed by regulatory agencies [13]. At the same time, restrictions on bank business diversity will severely hinder bank development and reduce bank stability. Some studies suggest that certain regulatory policies may reduce bank profits and efficiency [14-15]. Additionally, some scholars believe that government regulation of enterprises is significantly inefficient in certain aspects. Choi and Pritchard's research suggests that the public can expose the illegal activities of companies and banks through legal litigation, which is more efficient than government regulation [16]. Xu Youchuan's empirical analysis of data from 57 commercial banks in China from 2000 to 2008, using a simultaneous equation model, tested the impact of capital regulation on China's bank capital adjustment and risk levels [17]. He believes that under the pressure of capital regulation, Chinese banks may not necessarily meet regulatory requirements through the traditional method of "adjusting asset structure and reducing risk capital size." Therefore, capital regulation may not reduce the risk-taking level of Chinese commercial banks. Cheng Jie's research also found that capital regulation does not change bank risk preferences, and banks tend to supplement their capital and meet regulatory requirements by issuing stocks and bonds in the capital market [18]. In addition, higher information transparency may trigger excessive market reactions, leading to short-term impacts on banks and increasing bank risk levels [19].

3. Case Analysis

3.1. Case Review

Established in 1987, China CITIC Bank is one of the earliest commercial banks established during China's reform and opening-up period. In April 2007, it was listed simultaneously on the Shanghai Stock Exchange and the Hong Kong Stock Exchange through A+H share listings. With the vigorous development of internet technology, China CITIC Bank has undergone digital transformation and upgrades, promoting changes in business models and innovating financial products. In recent years, China CITIC Bank has steadily increased its asset size. According to the annual performance report released by China CITIC Bank Co., Ltd. in 2021, the bank has comprehensively developed a "new retail" system, successfully achieving synchronous growth in the market scale of its credit card business, with a credit card transaction volume of 2.780135 trillion yuan, a year-on-year increase of 14.5%. In September 2023, it was recognized as a systemically important bank.

On December 1, 2023, the Administrative Penalty Information Publicity Table of the National Financial Regulatory Administration showed that China CITIC Bank was fined 224 million yuan, involving 56 facts of illegal activities, including "improper classification of loan risks," "issuing a large number of loans under the name of holding bad loans," "improper risk isolation in wealth management business not in compliance with regulatory requirements," "some new product timing indicators not meeting new regulatory standards," "improper review of risks in interbank investment business and compliance review of fund direction," and "non-compliant information disclosure of wealth management products," among others.

China CITIC Bank was fined a total of 379 million for 18 major facts of illegal activities by the Financial Regulatory Administration. Among them, the head office was fined 20 million and branches were fined 17 million.

3.2. Reasons and Reflection

3.2.1. Insufficient Risk Control Capability of China CITIC Bank

The punishment of China CITIC Bank is inseparable from its own excessive asset risk, exposing its shortcomings in asset security under strict national supervision. Firstly, from the perspective of non-performing loans, loans, as one of the main assets of banks, directly affect the asset risk situation of banks. Improper classification of loan risks indicates that the bank failed to correctly assess loan risks, leading to underestimation or overestimation of loan risks, which may affect the true reflection of asset quality and increase the exposure of non-performing loans. Issuing a large number of loans under the name of holding bad loans directly increases the proportion of bad assets on the bank's asset side, thereby increasing the risk level of bank assets, which directly affects asset quality, reduces asset return rates, and may even lead to asset losses, thereby reducing the bank's solvency.

Secondly, from the perspective of a wealth management business, improper risk isolation not in compliance with regulatory requirements may not fully disclose the risk nature of specific assets, mixing high-risk products with low-risk products, which may obscure the true risk level. This makes it difficult for investors and regulatory authorities to accurately assess the bank's risk exposure, increasing the asset risks of investors and banks themselves. In addition, improper review of risks in the interbank investment business and compliance review of fund direction may lead to unclear fund flows and weak risk control. This may lead to banks holding high-risk interbank assets, increasing asset risks. Furthermore, some new product timing indicators not meeting new regulatory standards indicate inadequate risk exposure management when launching new products, leading to insufficient risk management by the bank.

In summary, the main reason for the punishment of China CITIC Bank this time is the insufficient supervision of its own asset risk security.

3.2.2. Regulatory costs drive banks to enhance risk management capability

The punishment of China CITIC Bank demonstrates the increased severity of national punishment in the field of financial regulation. Through this punishment, a clear signal of strengthening financial regulation and the importance of asset risk is transmitted to the relevant banks. This prompts relevant banks to strengthen risk management measures to ensure that asset quality and risk control comply with regulatory standards, thereby maintaining the stability and healthy development of the financial system.

The punishment of China CITIC Bank indicates that China's financial regulatory authorities have zero tolerance for illegal activities and are willing to take necessary actions to maintain financial market order and protect investor interests. This reflects the determination and strength of regulatory authorities in performing regulatory duties.

Delis et al. argue that regulatory authorities may have private information about banks' internal situations, and the release of regulatory measures sends negative signals to the public about banks [13]. Some research suggests that information disclosure can enhance bank transparency, thereby strengthening market constraints on banks, reducing bank risk behaviors, and enhancing bank stability [20-22]. Therefore, the implementation of regulatory punishment and other measures enhances market constraints, thereby reducing banks' risk preferences. The punishment of China CITIC Bank sends a clear regulatory signal to financial institutions, that operating in compliance with laws and regulations and protecting customer interests are the basic responsibilities of financial institutions. This helps to regulate the financial market order and enhance the compliance awareness and risk management level of financial institutions.

The punishment action conveys to investors the commitment of regulatory authorities to protect investor interests, enhancing investors' confidence in the financial market. This helps to enhance investors' enthusiasm and trust in participating in the market.

The punishment case can serve as a warning to other financial institutions, prompting them to strengthen risk management and internal control, and promptly identify and correct problems, thereby reducing systemic risks and instability in the financial market.

4. Conclusion

Through the analysis of reasons, it is concluded that China CITIC Bank cannot control asset risks, leading to significant asset risks. Under the trend of normalized strict supervision, the country has raised higher requirements for the asset conditions of banks, thus imposing penalties on China CITIC Bank. The punishment of China CITIC Bank this time demonstrates the country's emphasis on financial regulation and sounds the alarm for strengthening financial regulation, sending a signal of strong supervision to the market. Therefore, through the above case analysis, it can be seen that financial regulation has a significant impact on bank assets, and effective regulatory measures and systems are crucial for maintaining the stability and sustainable development of the financial market. In many foreign studies, scholars have conducted research on the relationship between financial regulation and bank behavior, believing that government financial regulation measures will hurt banks. However, in the analysis of this article, it is believed that the strengthening of financial regulation is beneficial to the improvement of bank asset risk conditions. Therefore, it is considered that, due to differences in national conditions and systems, the analysis methods of financial regulation and bank behavior in the West may not apply to a certain extent.

From the case of China CITIC Bank, it can be seen that the future financial market will move towards strengthening financial regulation and normalizing supervision. Under the trend of normalized supervision, it is of practical significance to standardize financial regulatory measures, which require efforts from all parties. Foreign research also has enlightening implications for China's financial regulation. From the government's perspective, in promoting the strengthening of financial regulation in the future, China should grasp the strength of financial regulation, ensure the formulation and improvement of bank regulatory systems and laws and regulations without affecting the stability of bank operations, and ensure the stability and independence of banks.

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