Research on China's financial risk prevention efforts and legal system support

Xiangyu Meng

School of law, University of Leeds, Leeds, LS2 9JT, UK

Abstract: Financial risks are highly destructive and can have a negative impact on the entire financial system, so financial risk prevention is an important area of research in the regulation of China's financial markets and requires the support of the legal system. In this regard, this paper first analyses the types of financial risks and the characteristics of prevention, and on this basis puts forward a series of suggestions for supporting the legal system of financial prevention, providing new construction ideas for the current prevention of financial risks in China.

1 INTRODUCTION

In the context of modern social development, regional financial development is an important guarantee of human social and economic development. Finance is a derivative of the development of the real economy and plays an important role in the process of market allocation. From a macro perspective, a stable financial system can effectively contribute to the development of the regional economy, and through financial leverage and a certain amount of financial planning, large amounts of capital can be channelled into more efficient sectors. However, because of the limitations of the current regional economic theory and the perception of the financial system in China, there are still certain problems in the construction of the economy and the change of the financial system by local governments. The most typical of these are the "financial instrument theory" and the "financial fiscal theory". From the 1990s, individual domestic regions have exploded the financial risk theory, and with the full outbreak of various domestic financial risks in the 21st century, some regional governments suffer from financial development anxiety, apparently one-sided emphasis on financial risk theory, fear of financial innovation and restriction of financial development will seriously hinder the development of the domestic financial industry [1].

Since 2011, China's financial and monetary policy has been improving and has been transformed from the loose policy of the previous crisis era to a relatively centralised and prudent policy. 2008 saw the outbreak of the financial crisis in the United States and in order to minimise the impact of this crisis on China's economic development, the country began to actively use fiscal and monetary and other financial instruments to deal with the financial crisis. However, in terms of practical effects, the national bailout policy still creates many unstable factors in the domestic economic environment, such as: structural imbalance of the domestic economy, uncoordinated regional development, inflation, social wealth transfer, etc. [2].

It can be seen that China's financial development is accompanied by a certain degree of risk, so in the future we need to rely on financial policies and legal systems to continuously reduce and prevent financial risks. A number of studies related to financial regulation and risk prevention have been carried out in China. Although these studies differ in terms of methodology and theory, most of them are conducted from a central regulatory perspective and their core research areas focus on macro theory, while there is less research at the micro, i.e. operational, level. At present, a clear division of labour has been established in China's important financial work: the Central Bank, the Banking Regulatory Commission and the Securities Regulatory Commission. With the development of China's local and regional economic regulatory system, the role of local governments in local financial risk prevention has also gradually deepened. It is proposed in the Macro Outline of National Economic and Social Development that the risk management system of local finance should be continuously improved, from which it can be seen that the prevention of financial risks in China still needs continuous in-depth study. In this regard, this study starts from the essential causes of financial risks, analyzes the current classification and prevention of financial risks in China, and discusses how to rely on the support of the legal system to establish a perfect local financial risk prevention system, in the hope that it can provide some reference for the financial prevention work of the government [3-4].

Corresponding author. Email: mxy__1005@163.com
2 TYPOLOGICAL ANALYSIS AND PREVENTIVE FEATURES OF FINANCIAL RISKS

Financial risks arise from liberal financial activities and corresponding financial policies, and there is a clear local dimension to the classification of financial risks.

2.1 Analysis of Financial Risk Types

2.1.1 Financial Credit Risk

The linked characteristics of creditisation and credit relations have predestined the importance and development significance of both in the modern financial sector. Credit risk has been and is one of the central sources of financial risk in periods of growth in financial activity and can be concentrated. At present, China's multi-owned wholly-owned commercial banks generally have a large number of non-performing assets, which can easily lead to a continuous decline in the quality of assets and credit, or in some cases, difficulties in interest recovery and a high number of overdue loans with bad debts. For local financial banks in China, because of their own smaller capital and scale of operation, they are only able to serve small and medium-sized enterprises, which leads to a higher possibility of credit risk episodes. In addition to local banks, microfinance companies are also among those that are susceptible to financial and credit risks because of the small and medium-sized enterprises they serve. In general, in addition to seeking to maximise their own interests, microfinance companies also have a role to play in supporting disadvantaged groups such as the "three rural areas" and small and medium-sized enterprises, thus not only seeking to develop themselves, but also complementing the large national banks and financial institutions. The above support groups are abandoned by large financial institutions because they can not meet the specified credit level and relevant credit standards. Therefore, in comparison, the violation rate of small and medium-sized enterprises will be higher and there will be greater credit risk. In addition, some unconventional credit institutions such as trust and finance companies, financial guarantee companies, securities companies, insurance companies and so on, their asset situation is even less optimistic. Some trust companies, in order to unilaterally pursue commercial investment interests, not only engage in lending business like commercial banks, but also have a big involvement in securities trading, thus leading to an increase in the proportion of their own non-performing assets. In summary, it can be seen that China is currently facing serious financial credit risks, both centrally and locally.

2.1.2 Financial Liquidity Risk

Because most financial institutions do not organise their assets and liabilities in a synchronised manner, the process of participation in financial activities and the behaviour of the parties involved are distinctly uncertain, and information on financial markets is incomplete, leading to an increase in liquidity risk in financial operations in the long term [5]. This phenomenon is mainly reflected in the banking sector. Non-bank companies are often unable to cash in on time when customers make large withdrawals, and the payment risk resulting from underpayments is also one of the most direct risks to the survival and development of financial institutions. Therefore, many financial institutions will currently make liquidity the primary goal of financial institution development, and pursue the principle of maximum profitability while ensuring liquidity. For local financial institutions, because of their own weak financial strength, relatively single business and limited social resources they can mobilise, they are more prone to payment disputes arising from capital chain flow problems, thus causing credit problems and eventually creating a vicious circle. In the long run, if the withdrawal needs of depositors cannot be guaranteed, it is likely to lead to a rise in their own indebtedness. In addition, because the current domestic real economy is in a slow place, resulting in even lower liquidity for local financial institutions, some regional banks are unable to recover funds in a timely manner, making it more difficult to meet the embodied requirements of their customers, and if there is a run on peers, it is likely to cause the collapse of the entire banking system.

2.1.3 Financial Operating Risks

In contrast to credit risk and liquidity risk mentioned above, the existence of operational risk is somewhat contingent. Because most financial institutions are market-based, market-based risks such as changes in interest rate securities may arise in the course of their day-to-day business activities. Large financial institutions, because of their size, financial strength and diverse product offerings, may experience short-term operational problems and financial losses when exposed to various types of market risk, but they will not have an overly large impact. For the weaker financial institutions, because of their own small economic scale and single business products, they are largely unable to avoid the large market economic risks, and therefore will be subject to a greater degree of financial impact. For example, in some state-owned enterprises or institutions in China, all sources of funding rely on government appropriations to finance loans, and over time various types of regional financial securities trading centres, property rights trading, etc. have emerged. On the one hand, these trading centres are characterised by a lack of content control due to the absence of clear regulatory norms and excessive speculation by local financial institutions; on the other hand, these local financial institutions can constantly influence the external market financial environment, transforming operational risks into financial risks and thus causing social unrest again [6].

2.2 Financial Risk Prevention Features

China's financial risk prevention work as an important component of the country's current macroeconomic system, its core content in the macro development and
with the universality of financial risk prevention at the same time also has a clear and detailed characteristics [7].

### 2.2.1 Diversification of Prevention Targets

Because of the diverse types of financial sectors in China, local finance possesses clear and specific attributes, which creates diverse characteristics of local financial risk prevention. On the one hand, the development of local finance shares the same objectives as national macroeconomic regulation and needs to respond and cooperate with national macroeconomic policies, and is therefore also influenced by the general economic policies of the country. Because of the country's macroeconomic policy orientation, including its changing political and geographical environment factors, domestic financial risk prevention needs to be aligned with the macro layout of the central and local regulators; on the other hand, local finance can be seen as a guarantee of local economic development, in line with the macro coordination of the regional economy, as well as a core source of local government finance [8]. Considering the approach to local government management in the context of relevant economic decisions, it is necessary to take into account the practical perspective of the government's work, for the prevention of financial risks to take into account both financial security and government development.

In addition to this, financial prevention as a public action, the goals pursued are bound to be complex and diverse. There are both economic and social considerations, so it is safe to say that modern China's financial risk prevention goals are distinctly diverse [9].

### 2.2.2 The complexity of the prevention process

With the continuous development of China's financial industry, business enterprises such as private finance and local credit companies have been emerging. On the one hand, private financial enterprises can indeed effectively promote local economic development, but they also contribute to a certain extent to the complexity of local economic development. If government regulation is too strong, it will inevitably inhibit the development of financial enterprises and hinder the local economy, but if regulation is too lax, it may lead to financial chaos and seriously jeopardise the public interest of society.

Therefore, the prevention of financial risks should combine dynamic and static processes. From a static perspective, the prevention of local financial risks should be the role of the supervisor of the financial market, whose core work lies in monitoring the risk signals of financial operations, and promptly identifying and making preventive measures against risk factors. This is a passive stance and should not interfere too much with financial institutions and financial operations at the local level under normal circumstances to avoid disrupting the normal financial market rules and hindering local financial development. From a dynamic point of view, the future prevention of financial risks in China should be such that assessment, early warning, control, resolution and aftercare are integrated. When the relevant authorities receive a risk signal, they are the first to make a proper assessment, assign a risk level and designate a corresponding resolution strategy. Financial risk prevention can be seen as a process of processing the flow of financial information and regulatory actions, and therefore all regulatory activities must be based on government management as well as on the vast amount of financial information available. Therefore, in the future, China's financial risk management and prevention work should start from the government's perspective, relying on the legal system to support and build a sound regulatory system.

### 3 LEGAL ADVICE ON THE PREVENTION OF FINANCIAL RISKS IN CHINA

The development of China's financial industry cannot be achieved without a quality and safe financial environment in the country, so the government concerned needs to build good risk prevention initiatives based on local financial risks to ensure the safety of the financial environment. Specifically, by improving the corresponding security laws and regulations, regulating the rights and obligations of each financial institution in each region, clarifying the functional responsibilities of each type of financial institution, ensuring coordination and cooperation among localities and controlling financial risks.

#### 3.1 Clarifying the System of Competence of Local Financial Authorities

**3.1.1 Clarifying the Core Responsibilities of Local Government Financial Management**

There is a lack of clarity in our government's authority to regulate the current financial markets, although the central and local governments have been improving their financial regulation over the years in the management of financial practices, there has not been much innovation in its main structure. They are generally formed under the authority and commission of the central authority and form the subordinate government regulatory bodies, these bodies have a lower legal hierarchy and local governments are often caught in a situation where they have no name in the regulatory process. So the primary consolidation walk for the prevention of financial risks in China in the future is to designate the relevant legal system and raise the legal priority, not only for central institutions, but also for local governments to continuously institutionalise and legalise local financial review and management bodies. All activities need to be based on the stable development of the economy, the regulatory authority of the central and local financial review bodies should be clearly defined, and the core responsibilities of financial management should be clarified. In addition, in view of the differences in the financial environment of different regions in China, and under the premise of ensuring the stability of the financial order, local governments' financial management
responsibilities should be differentiated, and the authority of financial supervision should be divided scientifically and reasonably to ensure the consistency of the central and local financial management authority and responsibilities. In this way, both the central and local governments can rely on the corresponding legal provisions to fulfill their responsibilities and improve the enthusiasm of supervising law enforcement officers in the actual financial regulatory activities. Local governments should give the relevant financial regulatory departments corresponding powers according to law, and clearly define the terms of reference and corresponding responsibilities of the general officers from a legal perspective, so as to not only effectively promote the development of the local financial industry, but also to maintain financial stability in the long run. For regions with a more complex financial environment, the government can centralize government financial audit departments, such as the Development and Reform Commission, the State-owned Assets Supervision and Administration Commission, the Ministry of Finance, and the Finance Office, into a unified local coordination effort to form a vertical and horizontal financial management model.

3.1.2 Clarify the legal boundaries of local government financial management

Boundaries are the definite limits of geographical extent and the division of different areas. In the legal field, boundaries are equally significant. The most obvious progress of the rule of law in modern society is the clear delineation of power and its relative binding force. The most important core responsibility of financial management analyzed above is to determine the financial management authority of local governments through clear legal provisions to facilitate subsequent financial supervision. However, if the boundary between law and financial management is blurred, there is a high risk that the work of regulatory authorities will overlap, or that a single authority will overstep its own enforcement authority.

An important principle of the exercise of public power is "not authorized, can not be, has been authorized, must be". For public power, the greater the power, the more should be clear management boundaries, establish the correct scope of regulation and regulatory philosophy, to avoid the emergence of different departments or departments and the market competition for power. At present, our government financial management should be limited to rural financial institutions, investment and financing companies, guarantee enterprises, local bond companies, and private financial enterprises. The most important thing is to realize the complementarity, mutual assistance and interoperability between the central and local regulatory authorities. To ensure that the latest regulatory information flows between governmental regulatory authorities, only in this way can we ensure the legitimacy of the central and local governments’ responsibilities and effectively avoid local financial risks [10-11].

3.2 Clarify the Financial Management System

China’s local financial management practice activities, according to the actual local situation, the need to build a corresponding legal system to supervise the core work of local risk management, based on the actual subject objects, the implementation of risk prevention work in the real area, to prevent superficial work.

3.2.1 Differentiated Management of Local Finance

China’s vast territory, the level of financial development in various provinces and cities and regions is not balanced, and their financial development positioning also differs. For example, large financial cities such as Beijing and Shanghai have concentrated the country's top financial management, macro-control institutions and large financial markets, and have profound market resources for financial development, which is also the top priority for financial development. Such a city, the core of China’s financial construction, needs to pay more attention to the stability of its own financial system, and future financial development should focus on resisting risks and establishing an all-round multi-level financial development system. While the financial industry in the north and southwest of China is relatively backward, it is necessary for the relevant regional governments, looking at the layout of the financial industry across the country, to establish different levels of development for different places, benchmarking capital strength, development, and comprehensive management, and building corresponding financial strategies to achieve differentiated management.

3.2.2 Establish Local Financial Risk Warning

Local financial warning is mainly responsible for the analysis and risk forecast of local financial activities in China, providing corresponding countermeasure suggestions for the safe operation of all financial activities, and always defining the financial risk situation and issuing timely warnings. At the present stage, the domestic financial early warning system is generally a prediction organic whole constructed according to the early warning signals of the financial industry development and the trend of changes, which needs to refer to various financial risk prediction indexes, while taking economic and financial data as the basis and industrial information as the basis, and assessing the corresponding industrial data according to the corresponding calculation model. In the future, China’s financial risks should further consider financial legal information and build a more scientific and stable matching risk warning mechanism. Its main work is as follows: firstly, establish a risk early warning indicator system with obvious local characteristics, which can not only orderly respond to the content of local financial risks, but also should be in line with the current regional financial environment background and orderly adjustment; secondly, establish a complete legal audit mechanism, analyze and judge local risk changes through the legal system, and timely analyze financial risks to
improve the accuracy and scientficity of risk prevention.

3.2.3 Legislation to Provide for a Financial Management System

To clarify the legislation to provide for a financial management system, it is first necessary to clarify the constitutional responsibility for local financial risks. The so-called constitutional responsibility is the legal responsibility arising from the contradictory activities of the laws and regulations formulated by the relevant departments. The basic state policy of our country is based on the rule of law, the core point of which lies in the administration according to the law. As a democratic country, the protection against infringement of rights is of the utmost importance. Financial risk prevention as a government public behavior, requires a large amount of social public resources, more should be clear supervision and control responsibilities; in addition, there is a need to clarify the administrative responsibility for local financial risks. Financial risk prevention, as an important part of the government's financial management work, belongs to the government's administrative behavior. Therefore, the relevant departments need to be held accountable for the corresponding responsibilities at all times, including administrative compensation, ordering rectification and administrative sanctions. In terms of the current financial administration law, China's financial law places more emphasis on individual responsibility rather than institutional responsibility, which has a weaker restraining power for government departments. Therefore, the future of China's financial risk prevention legal system, should clarify the administrative responsibilities of risk prevention agencies, to achieve two-way restraint.

4 CONCLUSION

The riskiness and destructive power of regional finance is high, and once it breaks out, it can easily affect the local financial system and have a great impact on the financial overall situation. Based on the financial construction needs, this study takes financial risk prevention as the research object, analyzes in detail the characteristic kinds of current financial risks from the perspective of financial ecology and mechanism, and proposes a legal system with the following core conclusions:

The current financial risks faced by China mainly include financial credit, liquidity risk, and operational risk. The current prevention efforts mainly include diversification and complexity features. Among them, financial credit risk is the core of local financial risks in the high-growth period, but also one of the most concentrated and urgent risks of financial risks. In turn, financial liquidity risk is caused by the mismatch between the asset-liability operations of financial organizations and their inherent power duration, and the existence of information differences in the financial markets of financial entities. In such a situation, financial institutions are prone to the phenomenon of insufficient payment capacity, which leads to financial risks. According to research and analysis, because of the current difficulties encountered in the development of the real economy, some local small financial institutions have lower liquid assets and a higher proportion of non-performing assets instead, which are likely to endanger the entire financial banking system if they are in credit risk for a long time. Finally, there is financial operational risk, which generally arises only occasionally and is caused by market factors behind the operational activities of small and medium-sized financial institutions, including interest rate risk, price risk and so on. To avoid such risks, the financial institutions concerned need to continuously improve their own business strategies to prevent financial operational risks from being transformed into other kinds of financial risks.

The future of China's financial risk prevention work needs the support of the legal system research, firstly, to clarify the management authority system of local financial management institutions, including the core responsibilities and legal boundaries of local government financial management; secondly, to clarify the financial management system, including the differentiated management of local finance, the establishment of local financial early warning system and management system, etc. Among them, the management authority system needs to be divided according to the actual situation of different financial institution regions, while the financial management system mainly includes differentiated management, risk warning management and financial legislation management, etc. In addition to this, the exit system of the local financial market is also the focus of the current financial management and legislative management, which requires the relevant departments to build a corresponding legal system to ensure the normal order of the financial market.

REFERENCES


