Review

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Risk Management and Non-Performing Disposal Pathways for Internet Loans in Commercial Banks

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Abstract: In recent years, with the development and advancement of information and communication technology, digital technology and inclusive finance have continuously integrated, leading to rapid growth in digital inclusive financial services, particularly online lending. In addition to microfinance companies and consumer finance firms, various commercial banks have actively expanded their online lending businesses, launching their flagship online loan products. However, as this sector continues to grow, credit risks have become increasingly prominent. Therefore, in the realm of bank online lending, effectively managing risks and swiftly disposing of non-performing assets are urgent issues that banks must address. This paper focuses on the perspective of non-performing asset disposal, analyzing the current risk control situation and existing problems in online lending, with an emphasis on how to effectively manage risks and carry out recovery and disposal.

Keywords: Internet lending; Digital technology; Risk management; Non-performing disposal

1. Development Status of Internet Loan Business

According to Article 3 of the "Interim Measures for the Management of Commercial Banks' Internet Loans" published by the former China Banking and Insurance Regulatory Commission in July 2020: "Internet loans refer to personal loans and working capital loans provided by commercial banks to eligible borrowers for consumption and daily production and operation turnover. These loans utilize information and communication technologies such as the internet and mobile communications, employ risk data and risk models for cross-validation and risk management, automatically accept loan applications and conduct risk assessments online, and complete core business processes including credit approval, contract signing, loan disbursement, and post-loan management." Banks provide loan services to customers through mobile banking, online banking, and other methods, significantly improving the efficiency of financial services and enhancing the customer experience. According to the "China County Digital Inclusive Finance Index Report 2022" released by the research group of the Rural Development Institute of the Chinese Academy of Social Sciences, due to the popularization of digital inclusive finance, residents in counties and rural areas account for a relatively high proportion of financial service transactions. More than half of the surveyed residents have obtained loans, with credit loans accounting for 73.4%. Among these, internet loans make up 57.5%. Internet loan business primarily exhibits the following four characteristics:

First, a large customer base. In addition to the customer groups traditionally targeted by financial businesses, banks can complete the entire loan transaction process with customers through online platforms such as mobile banking in counties and remote areas not covered by physical bank outlets. This significantly expands the bank's customer acquisition channels, including long-tail customers. Second, online risk prevention and control. By integrating and analyzing various data, banks develop risk control models that align with their risk preferences to assess customers' credit risks, shifting risk prevention and control from "offline" to "online." Third, reduced transaction costs. Under digital network platforms, banks and customers can complete the entire transaction process online, reducing reliance on physical outlets and significantly lowering the bank's transaction and labor costs.

It is evident that in the context of the digital economy, internet lending has its own advantages and will remain an area where banks actively invest and deepen their presence for a considerable period to come.

2. Risk Control Challenges in Internet Lending Business

While commercial banks vigorously develop online lending businesses, the associated risks have also become increasingly prominent. These primarily include:

2.1. Information Asymmetry Before Lending

Compared to traditional credit models, internet-based loans complete the entire process online, including loan application acceptance, risk assessment, credit approval, contract signing, and loan disbursement. Banks and customers do not meet face-to-face, making it difficult for banks to effectively and comprehensively assess the customer's creditworthiness, external evaluations, health status, and other factors. [3] For example, if a borrower successfully passes the online risk assessment and obtains a loan but dies due to illness within less than a year, the loan becomes non-performing.

2.2. Post-Lending Monitoring and Tracking Exhibit Blind Spots

The post-loan tracking and monitoring capabilities of online loans are highly limited, failing to automatically identify whether loan funds are misappropriated. In practice, some online loan contracts specify that the funds are intended for consumption or daily business operations, yet borrowers illicitly divert them to repay other debts or invest in stocks, real estate, and other financial channels. This significantly heightens credit risks for banks.

2.3. Inability to share data between online and offline channels, which may lead to risks such as multiple credit extensions.

According to data management practices at some banking institutions, when customers exhibit risk indicators such as overdue payments or interest defaults on offline loans, online credit models fail to promptly capture this information and issue timely warnings. This leads to situations where "loans immediately become non-performing," further exacerbating the burden of non-performing assets on banks.

2.4. Persistent Drainage by Illegal Loan Intermediaries

Some bank employees have weak compliance awareness, privately collaborating with illegal loan intermediaries. They routinely process loan applications that have been packaged or forged by intermediary agencies through normal reporting channels. Some even assist clients in fabricating materials to pass review processes in order to increase credit limits, posing significant risks to the bank's credit security.

2.5. Intense Industry Competition Leads to Difficulties in Customer Acquisition

According to data from the National Financial Regulatory Administration, by the end of the second quarter of 2023, the number of banking financial institution entities in China had reached 4,561. In addition to the previously fiercely competitive corporate banking sector, major state-owned banks have begun vying for market share in inclusive loans. In extreme cases, the average interest rate for their consumer loans can even fall below the 1-year Loan Prime Rate (LPR), pushing competition to near fever pitch. [2] As a result, regional financial institutions such as city commercial banks find it increasingly difficult to attract customers—particularly high-quality clients with strong repayment capacity—for their internet loan services, which lack a price advantage.

In summary, the risk management of internet loans faces significant challenges, with credit risk being particularly prominent. Some say, "The ultimate end of banking business is non-performing loan recovery." However, once internet loans encounter risks, the recovery and disposal of non-performing loans are far more difficult compared to traditional credit businesses.

3. Major Issues in the Recovery and Disposal of Internet Loan Business

3.1. Wide Distribution of Borrowing Entities

Borrowers of internet loans are often distributed across various regions nationwide and are not confined to the location of the lending bank. Although Article 5 of the "Notice on Further Regulating Commercial Banks' Internet Loan Business" issued by the China Banking and Insurance Regulatory Commission stipulates: "Strictly control cross-regional operations. Local corporate banks engaged in internet loan businesses should serve local customers and are prohibited from conducting internet loan operations beyond their registered jurisdiction." However, interpretations of "local customers" vary among banks. Some banks restrict local customers to within the registered jurisdiction of the financial institution, such as Ningbo Bank's "Ning Lai Hua"; while others define local customers as having "local household registration," "local business operations," "local salaried employment," or "local property ownership," among other criteria. Therefore, to a certain extent, internet finance has broken through geographical restrictions for borrowers.

3.2. Higher Risk of Insurance Claims

Internet loans feature low entry barriers, small amounts, broad audiences, high interest rates, and weak guarantee methods. Additionally, internet loans assess risks online, sign contracts digitally, and disburse funds electronically. With limited risk control capabilities, particularly in fully grasping borrowers' credit risks, they are prone to overdue payments and interest defaults.

3.3. High Number of Malpractice Cases Highlights Challenges in Case Filing

The volume of non-performing internet loan cases is substantial. According to a report by the Chongqing High People’s Court research group, "If all potential small loan disputes in Chongqing were filed in court, the number would equal the total annual caseload of all courts in the city." This situation is widespread across the country, particularly in regions with advanced internet finance such as Jiangsu, Zhejiang, and Shanghai. If all such disputes were brought to court, the current judicial human resources would be entirely inadequate. [1] This is especially true in areas where internet finance courts have been established, such as Hangzhou. These courts are even less equipped to handle and resolve such a massive influx of cases, making the difficulty of case filing particularly pronounced.

3.4. Limited Implementation Effectiveness

Internet loans are typically unsecured credit loans without guarantee measures. After a judgment takes effect and enforcement is applied for in such cases, the persons subject to enforcement often lack real estate and bank deposits. The primary enforcement measure is to freeze the funds in their online accounts, such as Alipay and WeChat. However, the current court inquiry and control system only supports balance freezing and cannot implement quota freezing, resulting in limited enforcement effectiveness.

3.5. Relatively High Public Opinion Risk

Defendants in online loan cases generally have low income levels and lack stable employment. After facing credit penalties, their employment and income situations may further deteriorate. If there are irregularities in the debt collection process, it could easily trigger new public opinion risks.

In summary, non-performing internet loan disposal has its own characteristics, and finding effective disposal methods deserves careful consideration. The author believes that risk management and non-performing loan disposal are two sides of the same issue. Only by strengthening risk management and accelerating the disposal of non-performing loans—thereby "preventing new risks while clearing existing ones"—can banks embark on a path of healthy development. Below, the author will discuss this from both risk control and debt recovery perspectives.

4. How to Enrich Risk Control Measures for Internet Loan Business

As some have pointed out, "The internet does not change the essence of finance; the core concepts, key principles, and important methods of risk management remain effective for internet lending." However, internet lending does differ from traditional lending. In addition to conventional risk control measures, the primary risk management approaches include:

4.1. Enhancing Risk Control Capabilities with FinTech

In addition to leveraging technology for customer acquisition, banks must also utilize it to mitigate risks. Firstly, it is essential to significantly enhance digital technology capabilities and strengthen the development of talent in the digital field, particularly by establishing and improving digital risk control models that align with their own risk appetite. These models should be adjusted in real time based on changes in the market environment.

At the same time, a comprehensive customer profiling system and risk model library must be established to continuously enhance the effectiveness, accuracy, and timeliness of risk control while reducing information asymmetry. Secondly, emphasis should be placed on the development of big data risk control. The core of big data risk control lies in data; efforts must be made to collect and reserve substantial data, particularly by breaking down data barriers between departments and systems to achieve deep integration and empowerment across systems. Collaboration with government agencies can be pursued to leverage public data marketization mechanisms, thereby expanding the reserve of data sources. Subsequently, big data technology should be utilized to process and analyze the collected and organized information, fully harnessing big data analytics applications to improve risk management capabilities. Thirdly, real-time risk control should be implemented. By combining customer profiling, risk model training, and other methods to generate risk rules, a real-time risk monitoring system can be established to provide timely risk warnings.

4.2. Develop specialized risk control measures for long-tail customers

Long-tail customers are characterized by small loan amounts, lack of collateral, and weak risk resistance, posing significant challenges to banks' risk control. For such customers, risk management should focus on three key aspects: First, effectively manage risk appetite. Adhere to the optimal balance between risk and return as the ultimate goal of operations. Second, ensure information symmetry and full-process management. Throughout the entire lifecycle of lending, fully understand the customer's risk profile and implement corresponding risk mitigation measures. Third, continuously optimize and iterate the risk models and strategies for online lending products. Conduct periodic risk monitoring, data analysis, and modeling to gradually reduce the delinquency and default risks of the online lending customer base.

4.3. Continuously Strengthening Internal Control and Compliance

First, it is essential to intensify the scrutiny of employees, particularly by routinely conducting specialized campaigns against illegal loan intermediaries and strengthening the monitoring of employee behavioral risks. Second, it is crucial to enhance the management of personnel trajectories. Specifically, dynamic management should be implemented for marketing staff, analyzing the marketing activities of account managers through mobile trajectory monitoring to address the root causes of risk management in internet loan businesses.

5. How to Conduct the Disposal of Non-performing Internet Loan Collections

5.1. Emphasize Self-Initiated Debt Collection

To effectively address the challenges in case filing arising from the court's source governance of litigation, the establishment of a debt collection mechanism is essential. Currently, banks primarily employ two types of collection mechanisms: first, in-house collection, where dedicated internal recovery departments handle non-performing loan collections; second, outsourced collection, where external agencies with collection qualifications are entrusted to conduct collections, while banks focus solely on managing these agencies rather than performing the actual collection work. [5] However, in recent years, due to illegal and non-compliant practices by outsourced collection agencies, the regulatory risks associated with outsourced collection have become increasingly prominent. For instance, the Zhejiang Office of the National Financial Regulatory Administration issued the "Notice on Issuing Guidelines for Standardizing Online Loan Collection Practices of Banking Institutions in Zhejiang" in January 2024, reflecting a continuously tightening regulatory environment. Therefore, the author argues that, under the dual pressures of expanding online lending business scales and heightened protection of financial consumer rights, banks must inevitably establish and refine their own collection mechanisms.

5.2. Judicial Collection: Promoting Negotiation Through Litigation

Regarding non-performing cases in internet loan businesses, to alleviate the difficulties in case filing caused by litigation source governance, differentiated litigation strategies should be developed for courts in different regions, while actively exploring the establishment of diversified dispute resolution mechanisms. Key measures include: First, revising standard contract terms. According to Article 22 of the Commercial Bank Law: "A commercial bank shall implement a financial system of unified accounting, centralized fund allocation, and hierarchical management across its branches. Branches of commercial banks do not possess legal person status and shall conduct business within the scope authorized by the head office, with civil liabilities borne by the head office." For loans issued by branches, the head office may generally serve as the plaintiff in litigation. Therefore, it is advisable to adopt more flexible jurisdictional clauses, such as revising them to "under the jurisdiction of the people's court at the plaintiff's location." This can facilitate case distribution and prevent excessive concentration in courts where the lending institutions are located. Second, flexibly employing various litigation methods, including applications for payment orders, small claims procedures, and "people's mediation + judicial confirmation" mechanisms. Third, utilizing notarization with compulsory enforcement, shifting traditional backend dispute resolution to frontend intervention for prevention. For example, the Cangnan Court in Wenzhou established a specialized team comprising "court + notary office" to precisely connect with financial institutions, achieving "group purchase rates" for notarization costs with compulsory enforcement. This significantly reduces notarization expenses and further expands and improves the diversified resolution mechanism for financial disputes.

5.3. Pilot Batch Transfer of Individual Loans

In January 2021, the former China Banking and Insurance Regulatory Commission issued the "Notice on Launching the Pilot Program for Non-performing Loan Transfers," marking the official beginning of bulk transfers of individual non-performing loans. Over three years have passed since then, and overall, the scale of the pilot program for non-performing loan transfers has shown an expanding trend. Since the pilot program was launched in the first quarter of 2021, the transaction volume has surged from an initial 50 million yuan to 47.52 billion yuan in the fourth quarter of 2023, representing a staggering increase of 950 times. These figures, to some extent, reflect the urgent need for commercial banks to offload individual credit non-performing loans, including internet loans. However, bulk transfers of individual loans also face issues such as low recovery rates, significant valuation uncertainties, and substantial losses for banks. [4] The author believes that bulk transfers of individual loans may become one of the methods for many banks to quickly dispose of internet loans in the future. Therefore, it is crucial to proactively interpret policies, understand the processes, establish sound internal valuation and pricing mechanisms, and maintain communication with potential investors such as AMCs.

6. Conclusion

The key to deepening and sustaining the development of internet lending businesses lies in enhancing risk control measures and accelerating the disposal of non-performing loans. Commercial banks must leverage technology to strengthen their technological capabilities, continuously improve risk management standards, reinforce employee conduct management, and adopt diversified dispute resolution mechanisms such as in-house collection and judicial litigation. These efforts will expedite the resolution of non-performing loans, thereby "removing obstacles" for the growth of internet lending operations.

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