

# The Impact of Interest Rate Liberalization on Chinese Commercial Banks

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**Abstract:** *Interest rate liberalization is a major reform for China's financial market, which now has entered the final stage-deposit interest rate liberalization, the success of this step will mark the end of interest rate liberalization reform in our country. In this paper, we first introduce the process of interest rate liberalization and the present situation in our country, then analysis the impact of interest rate liberalization which bring to China's commercial Banks, promote the reform of commercial banks, accelerate financial innovation, optimize the customer structure, standardize the external environment, conducive to the fair competition among commercial banks. But there are also some adverse effects, increase the interest rate risk and management risk, increase the pressure of competition between the industry, reduce banks' earnings, the impact on traditional business, put forward new requirements for banks' pricing ability, financial corruption, turmoil in the financial system. Finally draw lessons from the international experience of interest rate liberalization, introduces the concrete measures which should be taken in response to China's interest rate liberalization, strengthen the development of intermediate business, improve the pricing ability of commercial banks, enhance financial innovation, guard against interest rate risk, deepen reform of the system, form a good credit risk management mechanism, and pay attention to personnel training.*

**Keywords:** Interest rate liberalization; Commercial Bank; Opportunity; Challenge; Strategy

## 1. Preface

### 1.1 Background and Significance

With the rapid development of economic globalization, the business of financial institutions is constantly being reformed, and interest rate is becoming more and more important. The fluctuation of interest rate is directly related to the profit and loss of financial institutions. Therefore, a reasonable grasp of interest rate can make the financial institutions more profitable.

The development of financial industry in China has always been the government-leading and controls, while the system of our country economic development and the stability of financial order has played a very positive role, but with the development of economy, the limitations of this system are also increasingly prominent, its inhibition on financial innovation seriously weakened the international competitiveness of China's financial institutions. American economists Ronald McKinnon and Edward shaw put forward the "theory of financial repression" and "the deepening of finance". The former points out that interest rate control leads to financial repression, which makes the real interest rate far below the market equilibrium level, the capital cannot be effectively allocated, and the economic development is hindered. On this basis, the latter is put forward that developing countries limit real interest rates in the market equilibrium interest rate level for a long time, will result in a shortage of savings on one hand, on the other hand serious excess demand for credit, eventually make the non-price credit rationing of sex and social investment efficiency greatly reduced. Therefore, developing countries should give up the interest rate control, liberalizing interest rates, through the market spontaneous adjustment to make interest rate tends to equilibrium level, finally realizes the funds under the effect of market mechanism of effective configuration<sup>[1-3]</sup>.

In recent years, the role of interest rate liberalization in western developed countries economic development increasingly significant, it can make us thinking about how to apply the interest rate liberalization in China characteristic socialism economic system. The report of the 18th national congress of the communist party of China (CPC) proposed that we should comprehensively deepen reform of the financial system and improve the modern financial system that promotes macroeconomic stability and supports the development of the real economy<sup>[4]</sup>. The third plenary session of the 18th central committee pointed out that "making the market play a decisive role in the allocation of resources" shows that the reform of interest rate liberalization has become a core content of the reform of China's financial system.

Research shows that interest rate liberalization to accelerate the development of economy and the effect of greatly the efficient allocation of social resources, it is China's financial sector in the face of international financial market development trend, to adapt to the needs of economic globalization in the world<sup>[5]</sup>.

### 1.2 Definition of interest rate liberalization

Interest rate is the price of money, it is the ratio of interest and loan amount. Interest rate liberalization refers to the monetary authorities fully or partially out of the direct control of interest rates, is determined by the market main body independent interest rates, interest rates in the market capital supply and demand in accordance with the law of value under the influence of spontaneous. Therefore, under the market-oriented interest rate system, the decision by the financial institutions decide lending and deposit rates, the structure of interest rates spontaneous adjustment, according to the law of value is determined by market supply and demand autonomy, not directly by the central bank decided to<sup>[6]</sup>. However, the central bank will set a benchmark

interest rate, which is usually based on the benchmark interest rate, and the money market interest rate is the intermediary, which determines the interest rate of the deposit and loan by market supply and demand.

### **1.3 The content of interest rate liberalization**

#### **1.3.1 Liberalization of interest rate transmission**

Interbank lending rate can accurately reflect the short-term capital supply and demand situation. It is one of the most representative interest rates in financial markets. Therefore, it is the main content of interest rate liberalization that the rate of inter-bank lending rate is the criterion of interest rate liberalization.

#### **1.3.2 Liberalization of interest rate management**

The monetary authorities' control of interest rate is indirect, which cannot be used directly to control market interest rate. The central bank has indirectly affect interest rates, can use three major policy tools, namely open market operations, legal deposit reserve, rediscount rate to indirect adjusting interest rates, and to guide market interest rates.

#### **1.3.3 Liberalization of interest rate structure**

In the process of financial transactions, each participation main body for the term, have full autonomy on the choice of number of structure, the flexible way to meet various needs from both sides of the transaction, also played a significant role in the formation of the market equilibrium interest rate.

#### **1.3.4 Liberalization of interest rate decision**

The most important content of interest rate liberalization is that financial institutions have pricing power for their financial products, which mainly refers to the pricing of deposit and loan by commercial Banks. Commercial Banks will only make a reasonable pricing of the loans, and the interest rate liberalization will eventually be realized<sup>[7-8]</sup>.

## **2. The Process and Status of Interest Rate Liberalization in China**

With the development of social economy, the disadvantages of interest rate control are becoming more and more prominent. Therefore, the United States, Japan, South Korea and other countries or regions have abolished interest rate control and interest rate liberalization. It has been proved by practice that the implementation of these policies has played a positive role in promoting economic development. At present, the interest rate liberalization in our country is taking lessons from the successful experience of these countries. According to the unified deployment of the CPC central committee and the state council, the overall train of thought of China's market-oriented interest rate reform is to loosen monetary market interest rates and bond market interest rates, in turn advance deposit, loan interest rate liberalization.

On January 3, 1996, the people's bank of China established the national unified inter-bank lending market, which formed a unified inter-bank lending rate nationwide. On

June 1, let go of the interbank lending market interest rates in China, kicked off the independently by money lending both sides on the basis of market supply and demand determine the prelude of the market-based reform of interest rates, and laid a solid foundation for future reform. In June 1997, the interbank bond market was officially launched, and bond repurchase and coupon trading interest rates were released. In March 1998, the reform rediscount rate and the formation mechanism of discount rate, and liberalized the discount rate and the discount rate, thus basically realized the interest rate liberalization of money market. In September 2000, the people's bank of China released the interest rate on foreign currency deposit and loan, and realized the reform of the interest rate liberalization of foreign currency deposit and loan in China. In April 2003, the Chinese chemical group enterprise bonds were issued by market-based pricing, which marked the basic realization of interest rate liberalization in China's bond market. In 2004, the central people's bank raised its benchmark interest rate, while opening up the ceiling on lending rates and a floor for deposit rates. But since then, the deposit and lending interest rate liberalization in our country basically at a standstill, until June 7, 2012, the people's bank of China lowered the benchmark deposit and lending interest rates, and allows for the first time deposit interest rates could rise to 1.1 times the benchmark interest rate, restart the marked the liberalization of interest rate in our country. On July 20, 2013, the central bank decided to fully liberalize the lending rate of financial institutions and cancel the lower limit of lending rates, which marked the completion of the liberalization of China's loan interest rate<sup>[9-13]</sup>.

Through long and unremitting efforts, China's interest rate liberalization has achieved remarkable achievements so far. The interbank lending market, the bond market between Banks, discount, rediscount, the discount market and other money markets, interest rate liberalization has been basically realized. Financial bond market, corporate bond market, Treasury bond market and other bond market interest rates have also basically realized liberalization. For the liberalization of deposit and loan interest rate, our basic idea is "first foreign currency, later local currency; First loan, later deposit; First long, big, later short, small"<sup>[14]</sup>. At present, the interest rate liberalization of foreign currency is basically in place, the loan interest rate floor is cancelled, the basic trend towards liberalization, the remaining main task is to reform the interest rate liberalization.

## **3. The impact of interest rate liberalization on commercial Banks in China**

### **3.1 The interest rate liberalization has beneficial effect on commercial Banks in China**

#### **3.1.1 To promote the reform of commercial Banks in China**

For a long time, China's commercial Banks have a certain degree of political color because of interest rate control. Under such conditions, commercial Banks have problems such as poor management, lack of risk awareness, and low

operating efficiency<sup>[15]</sup>. With the gradual deepening of interest rate liberalization, the disadvantages of these problems are also increasing. Therefore, our country commercial bank must conform to the requirement of times development, change management idea, improve the management level, strengthen risk awareness, improve the efficiency of management, implementation of market-oriented interest rate reform<sup>[16]</sup> as soon as possible.

### **3.1.2 Commercial Banks gain autonomy**

In theory, interest rate pricing power is a basic power of commercial Banks. In the long run, commercial Banks cannot respond to the costs and risks of operations, and cannot reasonably allocate financial assets. But as the interest rate liberalization reform gradually thorough, our country commercial bank gradually grasp the market initiative, and have a real interest rate pricing power, implements the independent operation of commercial Banks, at their own risk, financial self-sufficiency, self-discipline. After the interest rate is determined by the market, the Banks will be more and more fierce competition, which makes the commercial bank to improve the authentic competitiveness, gain more market share, and realize the profit maximization and scientifically formulate business cost, optimizing the allocation of resources<sup>[17]</sup>.

### **3.1.3 Promoting financial innovation**

Reviewing the profit model of commercial Banks in China, most of them rely on deposit and loan spreads, which usually account for more than 80%. This pattern is rooted in the central bank's interest rate controls, in such an environment, higher than the stability of the market competition spreads, while guarantee the profits of commercial Banks, but also reduces the our country commercial bank and the international competitiveness between Banks. Along with the advancement of market-based reform of interest rates, commercial bank interest rate pricing power, in order to gain more market share, the loan interest rate is falling, deposit interest rates rise, gradually narrowing of spreads seriously affected the business income of commercial Banks. In such a background, the commercial Banks in order to guarantee profits and gain greater profit space, must break through the traditional mode of operation, to develop a variety of financial products and financial tools for financial innovation. To foreign experience, due to the marketization of interest rate decreases the stability of the spreads and lowered interest rates, which significantly increased the risk of interest rate, so to evade risk of financial innovation product development gradually appear on the market. For example, after the reform of interest rate liberalization in the United States, a series of financial products such as currency swap, interest rate swap, options trading and other financial products have been launched<sup>[18-20]</sup>.

### **3.1.4 It is good for commercial Banks to compete fairly**

During the period of interest rate control, the interest rate level was decided by the central people's bank. Commercial Banks had no interest rate pricing power, which enabled the government to provide the commercial Banks with an

environment of excessive profits. In this environment, the bank competition is mainly limited to mastery of deposits and loans, the non-price competition makes the commercial bank's overall competitiveness is not strong, and the phenomena of existing services. With market-oriented interest rate reform, commercial Banks can be according to their own capital supply and demand, the degree of business risk, management strategy and so on comprehensive consideration of factors such as operating costs, target profits, independently determine the interest rate, differentiation rate pricing. This has forced commercial Banks to change their competitive models and improve their operating efficiency. In the long run, competition between commercial Banks has become more transparent and equitable under the mechanism of the fittest. The transition from non-price competition to price competition puts new tests on commercial Banks and improves their competitiveness<sup>[21]</sup>.

### **3.1.5 Optimize customer structure**

Before interest rate liberalization, because of the fixed interest rate level, the deposit and loan business of commercial Banks in China mainly focused on large and medium-sized enterprises, and often ignored small enterprises. Because of the general situation, large and medium-sized enterprises are larger and their loan business is larger. After the interest rate liberalization, the customer structure of commercial bank loan business has changed. Because commercial Banks can determine the level of interest rate according to the cost of capital, the development prospect of the loan enterprise and the management expenses, and different pricing for different customers. Thus, it can reduce the loan interest rate of quality customers and compensate the riskier customers with higher interest rates. This rate pricing model not only attracted a good customer, make customer structure of commercial Banks, the varieties and disperse the risk of commercial bank itself, and improve its competitive power in the financial markets.

### **3.1.6 Normative external environment**

Under the condition of interest rate liberalization, the commercial Banks in China don't have to follow the same as before is prescribed by the central people's bank interest rates, but outside the removal of the benchmark interest rate, according to market supply and demand and their own situation to determine the level of interest rates, this makes the impact of commercial bank management policy, administrative and other external factors decrease greatly, which has a more standardized and orderly external environment.

## **3.2 The interest rate liberalization has harmful effect on commercial Banks in China**

### **3.2.1 Affect the earnings of commercial Banks**

Interest rate liberalization seriously affects the earnings of commercial Banks in China. Previously, our country implemented the policy of controlling the ceiling of deposit, opening the lower limit and controlling the lower limit of the loan. In this mode of management, the stable spreads

between the deposits and loans guarantee the majority of operating profit of commercial Banks. However, after the reform, Banks make deposit and loan interest rate independent pricing, and commercial Banks will raise deposit rates and increase the cost of capital in order to compete for market resources. Moreover, with the development of financial market and the diversification of financing channels, the bargaining power of commercial Banks on quality customers has been weakened, and loan interest rates have been reduced. As a result of these two aspects, the deposit and loan spreads will face severe tightening, which will have a great impact on the profitability of China's commercial Banks. After the liberalization of interest rate, financial market gradually perfect, some depositors will abandon low-yielding deposits and choose other higher-yielding investments, this competition from outside the system to reduce the bank's customer base, deposit interest rates rise and the loss of depositor commercial Banks face great difficulties<sup>[22]</sup>. Under the open financial market, foreign Banks because of the interest rate liberalization of rich experience, advanced management system, a variety of financial products such as advantage with stronger competitiveness, this will make our country commercial bank faces enormous pressure to survive, operating profit will be greatly reduced<sup>[23]</sup>.

### **3.2.2 Increase interest rate risk**

Interest rate risk is the possibility that market interest rate fluctuation causes profit or loss to commercial Banks. During the period of interest rate control, the central bank set a uniform interest rate standard, the spread of deposit and loan was basically stable, and the interest rate risk had little impact on commercial Banks. But when interest rate control is open, interest rate changes are frequent and large, which increases the interest rate risk for commercial Banks.

#### **(1) Interest rate structure risk**

The inconsistencies of interest rate fluctuations in deposit and loan interest rates will pose a structural risk to commercial Banks. When long-term spreads and short-term fluctuation margin spreads volatility is not consistent, or if there is any discrepancy between deposit and lending interest rate volatility, commercial bank assets and liabilities structure will produce uncoordinated, commercial bank's net interest income will be reduced.

#### **(2) Customer option risk**

Interest rate liberalization allows customers to have more deposit and loan options. When interest rates rise, customers can withdraw their deposits in advance and reinvest at higher interest rates. When interest rates go down, customers can borrow at a low interest rate and repay the high-interest loans ahead of time. In this way, the uncertainty of interest rate changes is bound to reduce the spread, making commercial Banks face greater option risks.

#### **(3) Interest rate sensitive notch risk**

The interest rate sensitive gap is the difference between interest rate sensitive assets and interest rate sensitive liabilities. After interest rate liberalization, interest rate

fluctuation is frequent and uncertainty increases, which increases the interest rate sensitive gap and increases the risk. When interest rate sensitive assets are greater than interest rate sensitive liabilities, interest rate falls and bank profit decreases. When interest rate sensitive liabilities are greater than interest rate sensitive assets, interest rate rises and bank profit decreases.

#### **(4) Yield curve risk**

The risk of yield curve refers to the non-matching of the term structure of the assets and liabilities of commercial Banks, thus the risk of uncertainty of their own earnings. In general, the yield curve to the upper right, long-term interest rates than short-term interest rates, but sometimes the bank assets and liabilities of term structure change will cause the change of term structure of interest rates, the short-term interest rate is more than long-term interest rates. Moreover, commercial Banks usually support long-term loans with short-term financing, so that changes in interest rates will reduce the earnings of commercial Banks<sup>[24-25]</sup>.

### **3.2.3 Competition among commercial Banks has increased**

Before interest rate liberalization, commercial Banks mainly relied on non-price competition to guarantee their position in the banking industry. This competition of deposit and loan amount continued to the reform of interest rate liberalization. Today, after the open interest rate regulation, the way of competition of commercial Banks have great changes have taken place, the traditional non-price competition to price competition, Banks in order to seek greater market share and generally adopt higher deposit rates, lower loan interest rates to attract customers. This competition for customers through differentiated interest rates has increased competition in the banking sector. High credit interest low interest loan way of competition makes many in size, financial strength, capacity, competitively priced relatively weak hard to survive, and small and medium-sized Banks face the fate of the bankruptcy or merged by big Banks. And foreign Banks of our country commercial bank also caused no small impact, because foreign Banks have more abundant experience in coping with interest rate liberalization, they are on the interest rate pricing, financial business innovation, risk monitoring, etc, have more advantages<sup>[26-27]</sup>. In short, interest rate liberalization will increase competition pressure between commercial Banks.

### **3.2.4 Test the pricing power of commercial Banks**

During the period of interest rate control, commercial Banks complied with the interest rate set by the central people's bank and did not need to set interest rate pricing. However, after the interest rate liberalization, commercial Banks have the pricing power of interest rate and the independent pricing based on market supply and demand and their own operating conditions. This puts forward new requirements for commercial Banks. For a long time, China's commercial Banks have weak pricing awareness and lack of interest rate pricing experience, which can affect their scientific and reasonable interest rate. Therefore, under the interest rate liberalization, the pricing power of commercial Banks will

face severe challenges.

### **3.2.5 Impact on the traditional business structure of commercial Banks**

The traditional operation mode of China's commercial Banks is mainly to absorb deposits and loans, and make profits by deposit and loan spreads. And under the condition of interest rate liberalization, this relatively single profit model cannot meet the needs of commercial Banks, the transition of the traditional business structure is the commercial Banks to keep up with the development of The Times to the inevitable choice. Finally, improving the intermediate business and developing financial products that meet the needs of customers are a great test of the financial innovation ability of commercial Banks<sup>[28]</sup>.

### **3.2.6 Increase the business risk of commercial Banks**

#### **(1) Liquidity risk**

Under the liberalization of interest rate, interest rate deregulation, the interest rate is determined by market supply and demand, this increases the interest rate changes of frequency and size, which reduces the stability of the deposit and lending, it goes on like this will exacerbate the liquidity risk of commercial Banks.

#### **(2) Credit risk**

Because of the asymmetry of information in financial markets, after interest rate liberalization, real interest rates generally rise, which will produce "reverse risk selection effect" and "reverse incentive effect". The "reverse risk selection effect" refers to the commercial bank is always willing to put money loans to borrowers who are willing to pay high interest rates, and some quality due to the high interest on loans to customers to opt out. In the long run, bad lenders who engage in risky projects will drive out the credit markets for quality lenders who engage in low-risk projects. The "reverse incentive effect" means that these bad borrowers invest in high-risk, high-yielding projects in order to pay high interest on loans. These two effects greatly increase the likelihood of loan default, improve the management difficulty of commercial Banks, and enlarge the credit risk of commercial Banks.

### **3.2.7 The growth of financial corruption**

In the context of interest rate liberalization, commercial Banks have their own right to operate, and they can independently formulate relevant deposit and loan interest rates according to the market supply and demand relationship and their own operating conditions. Under these conditions, if the lender in order to obtain a lower lending rates, will to bribery, for some corporations, human households and Banks also offer preferential rates, underground trade gradually grow. In the commercial bank implements the independent pricing and liberalization of interest rate under the condition of related legal system is not perfect, commercial Banks against scientific and reasonable pricing standard, such as fair trade increasingly rampant will induce financial corruption, even illegal crime<sup>[29]</sup>.

### **3.2.8 In the short term the financial system is**

### **destabilizing**

Practice shows that interest rate liberalization reform is a high-risk project, its impact on the banking sector in the short term, such as yields are low, the competition pressure, financial innovation breakthrough will be a large impact on the survival and development of commercial Banks, which have impact on the stability of the financial system. Moreover, the reform of interest rate liberalization has also put forward new requirements for our supervision system, because under the new market system, the loopholes of past regulatory standards are becoming more and more obvious. In short, interest rate liberalization in the short term will bring great turbulence to the original financial system.

## **4. International Experience of Interest Rate Liberalization**

### **4.1 Experience of interest rate liberalization in the United States**

In the early 1990s, with the liberalization of interest rate liberalization in the United States, financial markets took a big hit and interest rate risk became a huge challenge for commercial Banks. The frequent changes in interest rates, the expansion of the range, and the unpredictability have all increased the bank's financing costs and reduced the benefits. But after a long process, us interest rate liberalization has been relatively successful. Firstly, in the environment of interest rate liberalization, the competition law of the fittest has improved the competitiveness and comprehensive strength of the Banks, and eliminated many small and medium-sized Banks that are not well managed. Second, the U.S. government promotes interest rate liberalization. Moreover, the credit risk of interest rate liberalization enhances commercial Banks' ability to manage their own business. Finally, commercial Banks should also strengthen regulation to prevent the illegal trade and vicious competition under the interest rate liberalization.

### **4.2 Experience of interest rate liberalization in Japan**

Japan from 1985 to 1991, with 6 years with high efficiency to complete the liberalization of interest rate, but because of the influence of the trend of international and domestic actual situation, the liberalization of interest rate in Japan is not completely, the deposit interest rate is not decided by the commercial bank, the monetary authorities can on interest rates. And some small and medium-sized financial institutions are protected by the government, not facing bankruptcy due to fierce market competition. Japan to implement the results of the liberalization of interest rate cut both ways, first of all, Japan as an economic superpower, of implementation of market-oriented interest rate increase in international efforts to promote the competitiveness of domestic financial institutions, and perfect the market mechanism. But at the same time, Japan also faces interest rate liberalization and Banks invest in risky projects, accelerating the bubble economy and risking the financial crisis.

### **4.3 Experience in Korean interest rate liberalization**

South Korea's interest rate liberalization began in 1981 with the opening of interest rate controls on commercial paper, and was forced to reintroduce interest rate control in 1989 and ended in failure. The reason for the failure of Korea's interest rate liberalization is mainly because of the uncertainty of its own positioning, the failure to recognize the development of the international time and the actual situation of the country at that time, and the reform is blind. And financial regulation is improper, interest rate risk, credit risk is high, which can cause chaos of financial market order in South Korea, economic stagnation, and finally the financial crisis<sup>[30]</sup>.

## **5. Strategies adopted by China's commercial Banks to respond to interest rate liberalization**

### **5.1 Strengthen the development of intermediate business**

Our country commercial bank deposit and lending business and intermediary business is the main means of profit, interest rate control lift make frequent interest rate changes and unpredictable, interest rate risk become the main problems facing commercial Banks. Margin narrowed, floating interest rate, which greatly reduces the operating income of commercial Banks, and intermediary business has low cost and risk of small advantages, therefore, change the traditional business model, development of intermediate business is an inevitable choice for commercial Banks. But now, we develop intermediary business mainly settlement, agency, fees, etc, small scale, narrow range, the lack of variety, and the service level and backward technology, these are the problems we face. So, we should strengthen the cultivation of innovation ability, broaden the scope of business, the development of bank card business, the trust and leasing business, the guarantee business, provide for the customer asset management, financial advisory and investment banking services, make profit means diversity, increase the interest income source<sup>[31]</sup>.

### **5.2 Preventing interest rate risk**

In the risks of all kinds of interest rate liberalization, interest rate risk, commercial Banks to raise interest rate risk prevention awareness, build rate prediction, identification, measurement, evaluation, prevention of interest rate management system. Moreover, it is best to set up relevant interest rate risk control institutions to monitor the interest rate risk of commercial Banks. In the principle of interest rate risk management, the Basel committee stipulates that the principle of prudent interest rate management of commercial Banks mainly includes: the board of directors and senior management should properly monitor the interest rate risk; Develop appropriate risk management policies and procedures; Establishing scientific risk measurement and forecasting system; Improve internal control system and accept independent external audit. Therefore, commercial Banks should perfect the internal control mechanism of

interest rate risk based on the above four principles. Finally, the development of financial derivative instruments, such as forward interest rate agreements, interest rate swaps, interest rate futures, interest rate options, etc., can effectively avoid interest rate risk<sup>[32]</sup>.

### **5.3 Improve the pricing power of commercial Banks**

With an easing of interest rate regulation of commercial Banks to gain greater autonomy, but around the central bank set the benchmark interest rate of independent pricing of financial products, it is a great test for commercial Banks. The pricing of financial products relates to the operating income of commercial Banks. If the loan rate is too high, it will result in the loss of customers. If interest rates are too low, they will cut back on bank profits, so it requires commercial Banks to price them scientifically and reasonably. On the one hand, commercial Banks should establish special administrative departments to study the relationship between supply and demand of market funds and follow the interest rate pricing model to analyze the basic data of interest rates. On the other hand, commercial Banks, according to different clients' credit risk, loan duration, deposit and loan amount, etc., combine their own operating conditions to implement differentiated pricing strategy<sup>[33]</sup>. Finally, we will improve the system of interest rate pricing and control the unreasonable pricing of operation mistakes and insider trading.

### **5.4 Enhancing financial innovation capacity**

Nowadays, the rapid development of the financial markets to the needs of customers is more and more widely, and frequent fluctuations in interest rates increased the interest rate risk of commercial Banks, the serious influence its earnings, therefore, strengthen the financial innovation is the inevitable choice of commercial Banks. First, to increase the financial product innovation, such as broadening the intermediary business, the development of financial derivatives, in order to increase the diversity of products and services, and innovative tools to avoid risk is used to increase sales. Second, innovation of management system, to strengthen the commercial Banks internal control system of innovation, improve the ability of banking supervision, ensure the normal and efficient operation within the system, so as to enhance their competitiveness<sup>[34]</sup>.

### **5.5 Deepen the reform of the management system of commercial Banks**

With interest rate liberalization, the existing management system of commercial Banks cannot meet their own development needs. Therefore, shift operation and management system, perfect the corporate governance structure, sound and effective incentive mechanism is the commercial bank under the background of market-oriented interest rate to improve their competitiveness and guarantee the market position, increase the operation profit is the inevitable requirement.

### 5.6 To form a sound credit risk management mechanism

Market-oriented interest rate reform in the risk of "reverse choice effect" and "reverse incentive effect" increased the credit risk of commercial Banks, therefore, in order to reduce customer default probability, reduce loss, commercial Banks should strengthen credit risk management. First of all, commercial Banks should establish a mature credit rating system and conduct classification management for different customers. In addition, commercial Banks should strictly follow relevant procedures and standards for the approval of the lender's loan business. In the end, commercial Banks are also subject to regular supervision and management of the loan business, and use diversified financial innovation tools to carry out risk transfer.

### 5.7 Learn from foreign interest rate liberalization experience

The interest rate liberalization of many developed countries in foreign countries is earlier than our country, and the effect is remarkable, which provides many valuable experiences for the reform of interest rate liberalization in China. We are learning how to draw lessons from other countries on the basis of successful experience, strengthen the awareness of risk management, improve the system of financial regulation, and according to the actual domestic demand, create a suited to its national conditions, the road of market-oriented interest rate reform with Chinese characteristics.

### 5.8 Pay attention to the cultivation of talents

Finally, we should strengthen the cultivation of professional talents. Under the environment of long-term interest rate control in our country, interest rate risk consciousness weak, once the open interest rate liberalization, the risk of commercial Banks will strengthen consciousness, talented person's demand will increase in this respect. Therefore, commercial Banks should pay attention to cultivate senior management personnel, make the employees are proficient in the business processes and specialization, and the personnel training skills on a regular basis, increase the staff's professional skill and innovation level, to build a high-quality professional management team.

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