CREDIT RISK

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Abstract:
It is well known that today's developed market economies have been built with outstanding investment efforts, their high efficiency ensuring a rational use of natural resources and labour force.
At the same time, it is equally true that economic processes to happen, its need to take value shape, that is money. All exchanges are mediated by money, through their function of means of payment. A sizable part of investment, "economic engine" is materialized through credit.
The financial market is extremely volatile due to a large number of objective and subjective factors. Due to them, in their struggle to maximize profit, credit institutions are constantly facing with all sorts of risks.

Key words: *risk; credit risk; performance criteria; loan portfolio.*

JEL classification: G21

Introduction

Nowadays, companies find themselves in the midst of a revolutionary changes. The competition, as it was known in the industrial era, it turns into the information era-specific competition. Throughout the industrial era companies have had success by how well they were able to capitalize on the benefits of scale economies and the specifics of the industry. Today, technology exacerbates it's importance, because, ultimately, will be successful those companies that will be able to introduce faster and faster new technology in tangible and intangible fixed assets, generating standardized products of the highest quality.

In these circumstances, the volume of transactions being huge (both in number and in value, as well), we can easily see the role of banks as one of first importance. From facilitating the foreign trade, continuing with savings' collection in the form of deposits and to issue money, by means of the credit, the credit institutions are a constant and more and more intensified presence in the daily life.

Risks can have a considerable influence on the credit institutions, which influence is felt both in direct losses recorded, and influence whose effects are felt on customers, employees, business partners and even the bank's authority, as well. The risk is generated by a large number of transactions and procedures and for this reason, at least in the financial sector, the risk should be considered as complex of risks, in the sense that a risk may cause other risks. As a consequence, these operations and procedures, can permanently generate a risk exposure.

Therefore, credit risk - so called the risk of counterparty or risk of customer's insolvency - is one of the most important risk the banks cope with. The loss may be total or partial. This risk increases with the number of customers, the amount of the loan granted and the interest rate level. In managing this risk, banks follow the preparing and analyzing a file of lending, establish rules for the division of risk and seek to diversify the loans portfolio.

1. Literature review

There are a number of reasons that reveals the importance of credits' monitoring. Thus, finding out the situation of the customer, as well as of business, and the possibility to pay the debt to the bank, overviewing the contrary trends, so as to take preventive measures, lap to confirm the use loan in order to rule out or confirm the information given by the customer, enabling the bank to discover the unusual practices used by the customer, in order to inform bank about the customer's business and trustworthy, ensuring that the client is still solvent, there are reasons that show that, in addition to the complex process of granting credit, monitoring of loans is a very important and absolutely necessary step in conducting a loan.

From the approval and granting of bank's loan and up to full repayment of all the incurred debts, the purpose of credit's monitoring progress is to keep all the original conditions of the lending. This, in order to prevent that an initial credit performance to become unperforming due to the deterioration of the economic-financial situation of the borrower.

Credit monitoring is carried out by the credit officer in a practical way on the basis of a schedule at the branch's level, established by the credit committee. Loan's monitoring shall be carried out on a monthly basis or whenever it is needed, i.e. whenever there is information, the economic and financial situation of the customer has the tendency of decline.

Risk exposure is limited in most countries, in order to eliminate the use of unilateral bank resources in favor of a few large customers or by placing the resources in one sense and, therefore, to avoid the use of the bank's potential in a monopolistic way.

As far as banking activity is concerned, there are national rules which prevent exposure to risk, the regulations aim being the risks' division, forming an integral part of the strategy to prevent risks.

By reducing the maximum amount or loan settlement for an entrepreneur the bank lowers the risk of contagion and diminishes the possibility of taking over the risks, which can lead to bankruptcy. In Romania it's settled the maximum exposure to a debtor for 20% of the own funds of the bank.

In the second place, it is settled the aggregate maximum exposure which cannot exceed 8 times the own funds of the bank. The maximum aggregate exposure is for large borrowers. The debtor is considered to be large bank's customer if it has total liabilities towards the bank, an amount that reaches or exceeds 10% of the own bank's funds.

Concentration of risk prevention on large clients has an important role in risk dispersion and, on this basis, the safety of operation. Avoiding and limiting large risks print a climate of hygiene in banks, removing possible abuses and their negative effects that affect, in fact, other participants in economic life, from savers to entrepreneurs.

2. Risk management

One of the first requirements of prudence in the banking business refers to the size of its commitment to the business which stress, on one hand, its capital size when established and on the other hand, the extent to which the bank is able to cover debts to third parties in cases of extreme illiquidity or insolvency.

Banking rules stipulate the obligation of banks to ensure a minimum level of liquidity, determined according to the bank's claims and engagements maturities. General rules of liquidity are designed, in principle, to provide coverage and respectively, to permanently maintain the inequality:

$$\text{Liquid assets} \backslash / \text{Liabilities exigible} > 1$$

Liquidity is, ultimately, a matter of cost:

► on one hand, the availability of liquidity in surplus to requirements, means unnecessary costs;

► on the other hand, the emergence of inappropriate requests of liquidity amid an erroneous predictions or consciously reduced, leads to the availability of resources in terms of pressure, premise of much higher costs.

Ensuring liquidity is a permanent task and of a sensitive variation for any bank and its constitutes an current objective of the National Bank of Romania's (central bank) staff involved in banking supervision.

For prudential requirements exemplification are given, in the tables below, the most important indicators:

Table 1. Main indicators regarding prudential banking (percent)

Period	Past due and doubtful claims (in total assets)	Past due and doubtful claims (in total debt)	Credit risk ratio*	Liquidity indicator	Non-performing Loans Ratio**
2010	0.29	0.32	6.52	2.47	x
2011	1.01	1.1	15.29	1.38	7.89
2012	1.49	1.63	20.81	1.36	11.85

* Gross exposure of loans and interest classified as doubtful and loss / Total classified loans and related interest.

** Gross exposure of loans and interest classified as loss 2 that is overdue more than 90 days and /or for which legal proceedings were initiated against the debtor or against the operation / Total classified loans and related interest.

Source: compiled data from NBR reports

Table 2. Information regarding global risk

Period	Global risk (mil. lei)	Past due amounts (mil. lei)	Debtors number	Past due debtors (individuals and companies)	Number of queries
2010	226380	3323	1027722	138946	309967
2011	226393	7840	986042	201646	310086
2012	237510	15035	957206	218401	146933

Source: compiled data from NBR reports

Basic banking rules require the classification of loans and unearned interest involved and the settlement of the specific provisions. By the nature of the activity and its interests, the bank must be selective in dealings with customers, both in the period of signing the contracts, as well as during their use.

Considering that the selection of the customers provided from the beginning a prerequisite for equal risk to all categories of loans and that the minimum requirements of guarantee and prudence have been met, the selective attitude of the bank must continue.

Banks are engaged in an activity of knowledge and analysis of customer needs and, consequently, on the evolution of respective credits.

Table 3. Credit evolution during 2011-2012

- million lei -

Period		lei	foreign currency	total credit
2011	Jan	37.555,4	38.429,9	75.985,3
	Mar	37.066,1	37.914,5	74.980,6
	June	36.737,3	37.374,2	74.111,5
	Sept	36.587,5	37.068,1	73.655,6
	Dec	36.046,6	36.978,1	73.024,7
2012	Mar	35.213,3	35.598,3	70.811,6
	June	28.317,0	39.519,2	67.836,2
	Sept	27.784,7	37.951,2	65.735,9
	Nov	26.758,5	37.724,2	64.482,7
	Dec	26.538,5	37.849,0	64.387,5

Source: compiled data from NBR reports

Tabel 4. Past due credits during 2011-2012

- million lei-

2011	March	June	September	December
Past due credits in lei	2,540	3,257	3,811	4,465
Past due credits in foreign currency	1,926	2,244	2,699	3,692
2012	March	June	September	December
Past due credits in lei	5,252	6,451	7,320	7,602
Past due credits in foreign currency	5,165	7,185	8,778	8,556

Source: compiled data from NBR reports

To protect against losses on loans, banks use, both to be provisioned and cession of insurance risks, as well. Thus, the bank may end insurance policies with specialized institutions, in order to cover the risk of losses from the credit portfolio.

3. Consumer credit; a quick overview

Consumer loans have been convicted in the last period. If the guilty were banks in 2009, towards the end of 2010 the culprits have become citizens. In reality, the rapid expansion of the category of consumer loans in foreign currencies, loans, credit with ID cards, consumer loans with mortgage etc. was due to the model of the financial market in Romania.

Discussion about consumer credit should be nuanced. They nor have generated and neither have magnified the crisis but the faults of the Romanian financial structure outline, coupled with wrong economic policies. Consume has stimulated prior growth, but, at the same time, it partly cushioned the fall.

Our financial system has favored the expansion of consumer credits in foreign currency.

Large minimum reserve requirements raised the financing costs, favoring the financing which generate income more important. In this context, it was impossible to develop motivation for investing in human capital needed for corporate financing.

When lending consume for the banks is important the evolution of the portfolio as a whole, not each individual behavior. Macroeconomic evolution does influence the distribution and structure of the portfolio. Deepening and prolonging the crisis led to an increase in the losses of the banks' portfolios, amid pro-cyclical measures hard to predict required by NBR (maintenance of high interest rates) and Government (VAT increase).

The need for consumer credits has not disappeared and the advertising for these loans suggests that the industry clearly perceive otherwise. A few elements suggest the existence of the space necessary to continue funding through consumer credits: firstly the fact that the new generations enter into the areas where they require such needs. Estimates of grey economy suggests the existence of alternative sources for consumer-credit repayment.

Basically, the bankers are looking at nonperforming loans rate, approaching 20%, including it in the cost of credits, such as the good customers-debtors to cover losses caused by those who do not repay loans. Interest on consumer loans in lei remained over 16 percent a year, and companies pay for financing in lei interest rates of 14% per annum, according to NBR.

Banks defer deletion of nonperforming loans (which would mean assuming a certain losses), which creates a negative state of mind. For example, in the real estate market everyone thinks prices will fall when the banks will begin to cleanse their balance sheets and will move on to run the table. Assuming, however, would mean losses for the bankers the need to reduce further the cost-which involves the closure of companies, including layoffs and salary cuts-or even the need for recapitalization. Over 85% of the assets in the system are owned by banks with foreign shareholders. Last year banks capital increases were made to include over 600 million Euros, in most cases at the request of NBR, which was concerned about maintaining an adequate level of capitalization. Business people say that too much interest on credits cut consumer appetites of customers, so companies do not have any for whom to produce.

Data published by the National Bank of Romania show that, at the end of 2012, the provision made for past due loans over 90 days exceeded 22.8 billion lei, 2.6 times more than in December 2008. At the same time, the provisions for over due credits between 61 and 90 days, was 6.6 billion lei, with 65% higher than at the end of 2009.

Table 5. Information regarding past due loans of individuals

Period	Number individuals with past due >30 days	Number past due	Total	Past due amounts (million lei)				
				Currency		Delays		
				Lei	Euro	> 31 < 60 days	> 61 < 90 days	> 91 days
2012 Jan	691 207	1 041 649	3 260,7	1 974,7	1 024,7	73.4	71.2	2 442,4
Mar	677 485	1 015 694	3 617,3	2 113,0	1 170,5	85.5	79.4	2 689,2
June	714 071	1 067 062	4 459,7	2 416,8	1 542,5	74.9	103.4	3 313,0
Sept	734 152	1 086 500	5 033,0	2 640,3	1 796,9	82.8	100.5	3 753,1
Dec	720 661	1 051 555	5 488,2	2 673,6	1 971,2	79.5	89.1	3 925,1

Source: compiled data from Credit Bureau Statistics

The data in the table below, obtained by processing the information presented by the Central of Bank Risks and Credit Bureau, gives an self-evident image:

Table 6. Number of past due debtors 2011-2012

- mill. lei-

Period	Number Debtors	Number past due debtors	Number debtors in reorganization	Amounts	Number debtors in bankruptcy	Amounts
Dec. 2012	957,206	218,401	247	585	672	484
Sep. 2012	973,659	242,116	228	495	547	427
Jun. 2012	984,703	230,814	198	444	541	455
Mar. 2012	970,148	212,513	147	231	499	378

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