

CREDIT RISK - A MAJOR RISK OF CREDIT INSTITUTIONS IN ROMANIA

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***Abstract:** Nowadays the risk is a fundamental feature, which is found in any environment, an economic environment, banking, or a monetary one. This problem regarding the risk stems from the fact that we live in a civilization surrounded by risks, which are the result of the changing environment in which banks operate with new options to expand their businesses. Following the activities of the bank, with regard to their operations implemented for maximizing their profits and expansion occur banking risks. Bank must identify and manage properly the risks that may arise, facing thus the competition and rising the profit and the position they occupy in the market. In this paper we propose to realize an analysis of the structure of the loan portfolio in Romania in 2009-2013, but also the evolution of the indicators of quantification of credit risk in Romania. The study concludes that credit risk in Romania is still a major risk faced by credit institutions. A positive aspect that we have identified is the slowdown in non-performing loans during the same period.*

Key words: risks, credit risk, nonperforming loans, provisions

JEL classification: E50, E51

INTRODUCTION

Many specialists associate the risk with the uncertainty (Trenca, 2011). We often find in the literature how risk binds to uncertainty, insecurity, even if the two of them cannot be replaced with each other. Uncertainty is the lack of acquaintance with any field development in the future. The difference between the two is that risk can be identified, surveyed, controlled and as following the management conceded by various processes and appropriate methods.

The credit institutions may face many types of risks that can affect their work through some influences on the financial statements and the future of their profits. Any banking activity involves a risk. Therefore, there is always a risk, he came like a shadow over the business of the bank and is produced or not depending on the opportunities that may occur (Nitu, 2000). The banks are required to pay particular attention to risk management, as they are exposed to general risks encountered not only in the market economy, which refers to any economic agent (liquidity risk, default risk, risk management, risk capital) but also to specific risks of their work, such as credit risk, currency risk, correspondent bank risk, settlement risk, risk communication, risk of fraud, reputational risk. Each institution is permanently vulnerable to risks within their daily activity, which may have a negative impact on its activity in the market and thus may affect the image and credibility of the bank. Therefore, the focus is on risk management that ensures the permanent income and the solvency of the bank.

Overall bank risk management involves the following steps (Trenca and Silvestru, 2011): The identification involves setting up the factors that may have a negative impact on banking activities by collecting data and determining, based on them, if there is the

possibility of a risk to occur or not. After identifying the risk the bank shall pass to the next stage of risk management.

The evaluation occurs after data collection necessary to establish whether the risk is acceptable, so that can allocate funds to cover the risk identified. If the risk is too high for the bank, it will not be accepted and the bank moves to next step of the control process.

There are two possibilities in the control phase: the first is to minimize the risk through internal means and methods, and the second involves transferring this risk through insurance against the risk of a third party. Credit risk is considered in the literature and basic risk represents the loss incurred by a financial institution, if the entry of default of a borrower or damage its ability to repay the loan, which is the time reduction credit quality. This is the most important risk of the product market, appearing due to the depreciation of value, as a result of bankruptcy or loan default.

If credit risk meet the following factors (Trenca, 2011):

- Exposure o non-reimbursement risk;
- Non-reimbursement probabiliy;
- Transaction probability - is the possibility that the solvency of a debtor to be worse, or to improve in a certain period of time;
- The loan recovery rate after the debtor becomes unable to meet its payment obligation;
- The relationship between the probability of default of the debt and the transaction probability.

The probability of non-reimbursement - this is the most important factor that leads to a significant credit risk. This factor can be estimated from the financial data recorded by the company in the balance sheet and the profit and loss account.

NONPERFORMING LOANS AND THEIR RECOVERY OPERATIONS

The loans granted by the banking institutions are highly exposed to credit risk, non-reimbursement credit risk and non-payment of its related debt, that is interest and fees, represented by the bank claims on customers. The consequences of this risk for the banks is their failure to achieve the income and also their loss of working capital affecting the financial condition of the banking institutions. In order to limit the effects of the risk, there are specific provisions of the credit risk intended to offset the already made risk in a given time. These provisions are created for loans granted to non-bank and bank customers.

The process of monitoring the loans carried out by a bank include:

- The permanent analysis of all credits or, to ensure that they are conducted pursuant the credit policy applied by the bank, the entire documentation in accordance with and in terms of profitability.
- The calculation of the key indicators to see the performance of loans and their classification into a specific category;
- The accounting expertise on the quality of the loan portfolio that the bank may capitalize.

The diversification of the loan portfolio represents an optimal way to control the risk and increase the profitability. So they have in mind two purposes (Cocris and Chirlesan, 2009):

- minimizing the risk;
- maintaining and enhancing the existing profit.

The consequences of the economic crisis within the banking system were represented by a slowing down of the crediting activity, and banks changed thus their strategy from a fast expansion to a prudential activity. Consequences like growth of unemployment,

reducing the number of businesses, reducing the income in the budgetary sector have led to a decreasing capacity of reimbursing the loans, therefore this fact would have affected the bank's loan portfolio and banks are forced to increase the amount of provisions. The growing concern of the Romanian banks to adjust their balance sheets; maintaining a prudent behavior in their crediting activity, on a continued deterioration of the credit portfolio quality and of the significant costs incurred in the process of creating the provisions for credit risk; the limited amount of funding sources on medium and long term denominated in national currency, the relatively low level of economic growth; the attempt of maintaining the risk aversion and limiting the currency loans to borrowers that are exposed to currency risk are some of the factors potentially contracting the crediting activity (www.bnr.ro, *Financial Stability Report for 2013*). The still modest dynamics of the economic activity, associated to a tendency of restricting the crediting activity, had as result the enlargement of the process of gathering the bad loans, which had a strong effect over the quality of banks' loan portfolio (www.bnr.ro, *Financial Stability Report for 2013*). Nonperforming loans represent those loans that are characterized by a higher credit risk, caused by one of the following reasons (www.rbs.ro):

- the debtor's business and financial performance has been deteriorated or he went into payment default and declared his insolvency, so it is clear that the debtor cannot pay his debts with maturity terms to the banking company that granted him the credit;
- the bank indirectly learned important information about some events that may have a negative influence on the activity carried out by the borrower, which may damage the borrower's performance and may lead to its inability to pay its debts at maturity term to the bank;
- due to the occurrence of some unusual events such as fraud, bad economic conditions, inadequate management, which can lead to situations where the debtor is unable or unwilling to meet its obligations to the bank at maturity. According to the Romanian National Bank, the loans overdue for more than 90 days are considered bad debts entering the category of losses.

An important place in the management of credit portfolio returns to Credit Risk Control (CRC), which deals with the collection, storage and handling of the information on borrowers who receive loans and data related to card fraud. The loans granted by banking institutions are tracked by Credit Risk Control (CRC) in order to monitor and maintain a certain level of risk so as to prevent an economic disaster.

THE ANALYSIS OF NON-PERFORMING LOANS IN THE ROMANIAN BANKING SYSTEM IN THE PERIOD 2009 – 2013

In order to follow the analyses of financial stability, the Romanian Central Bank uses the indicator "non-performing credit rate" for assessing loan quality. The non-performing credit rate is the main indicator that evaluates the quality of the loan portfolio from a prudential perspective, being calculated on the basis of the prudential reporting related to credit and their classification. In 2009, Romania ranks first place in terms of non-performing credit rate in Central and Eastern Europe. This increase is due to lower revenue recorded at that moment, which strongly affected the banking system, thus the net profit declined by 83% over the previous year. Since 2009, banks have begun to slow down their lending activity, they changed their mentality, giving up to fast expansion and addressing a qualitative orientation, they focused on new strategies, branch network, product portfolio etc.

Aurelian Dochia states that increasing the share of bad loans in the Romanian banking system has occurred gradually over a period of several years, this enabling banks to adapt to credit risk.

In chart no 1 we can see an evolution of the rate of bad loans in the Romanian banking system in 2009-2013, a graphical representation based on the information in the table in Annex no. 1 At the beginning of 2012 there has been registered an increasing outstanding loan rate of 16.28%, which increased continuously reaching at the end of 2012 to 18.24%.

At the same time, losses from crediting activity rose very quickly. This indicator is due to some constraints arising in customers' lives. Therefore the percentage of bad loans continued to increase, from 6.46% in September 2009 to 19.08% in March 2013. This increase has been caused by a serious damage of the entrepreneurs' business, or borrowers who couldn't meet the cost of its credit and rates thereof. Another indicator used for analyzing and managing the credit risk is represented by the credit rate.

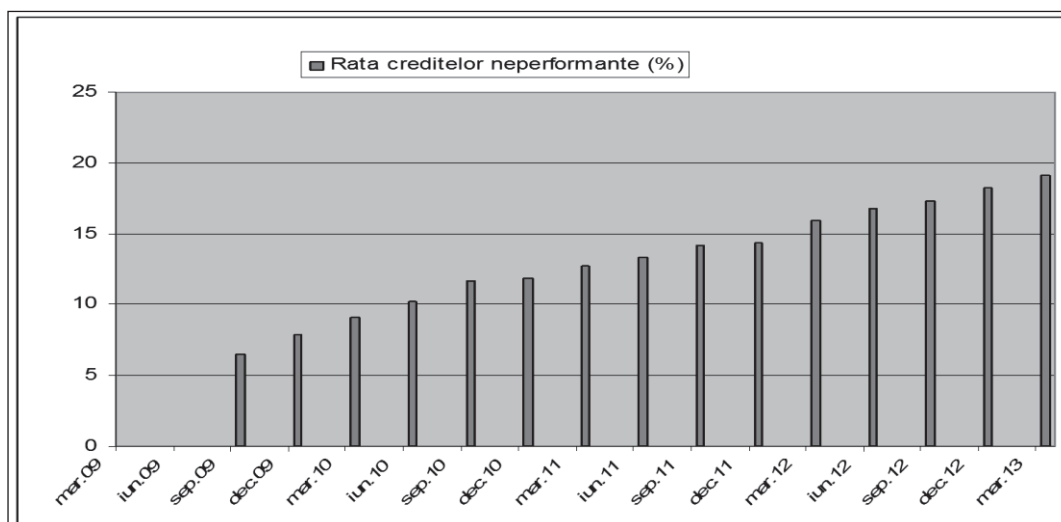


Chart 1. The evolution of non-performing credit rate indicator of the Romanian banking system in 2009-2013

In chart no. 2 we can see an evolution of the values registered by this indicator in 2009-2013.

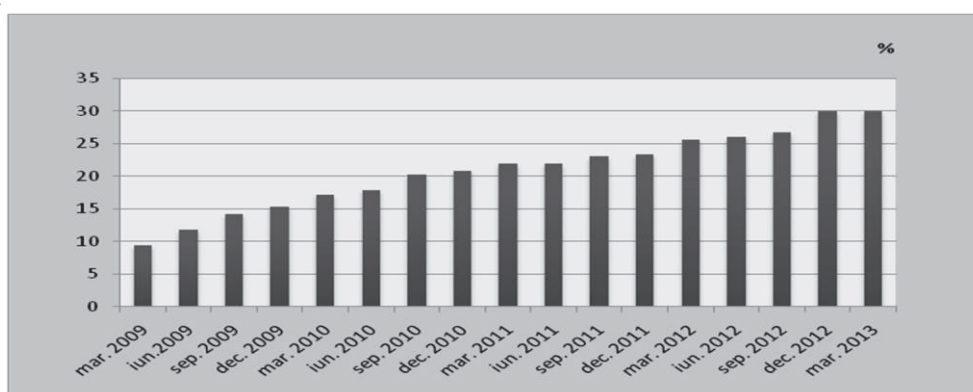


Chart 2. The evolution of the indicator of credit risk rate in the Romanian banking system in 2009-2013

Following the analysis of the evolution of credit risk rate indicator it can be observed a constant oscillation to increase and decrease, it recorded the highest value in March 2013 of 29.98%, with 20.58% more than in March 2009. This increase is due to the fact that the banks still granted loans and borrowers fail to meet their payment obligations to the banking institutions. In chart no. 3 we can see a comparative evolution of some representative indicators of credit risk in the Romanian banking system in 2009-2013,

reflecting lending risks, including general rate of risk and credit risk rate and the evolution of the non-performing credit rate.

With regard to the values registered by these indicators, we can see in the above chart that the year 2009 had been recorded the highest amount of general rate of the risk of 50.23%, followed by a decrease ranging and ending in December 2012 with 38.80%, which is the lowest value recorded in the last four years. Also, there is a considerable increase in credit risk reaching 29.98 in 2013. There is no improvement of the situation of non-performing loans, they are growing, registering the highest value in 2013.

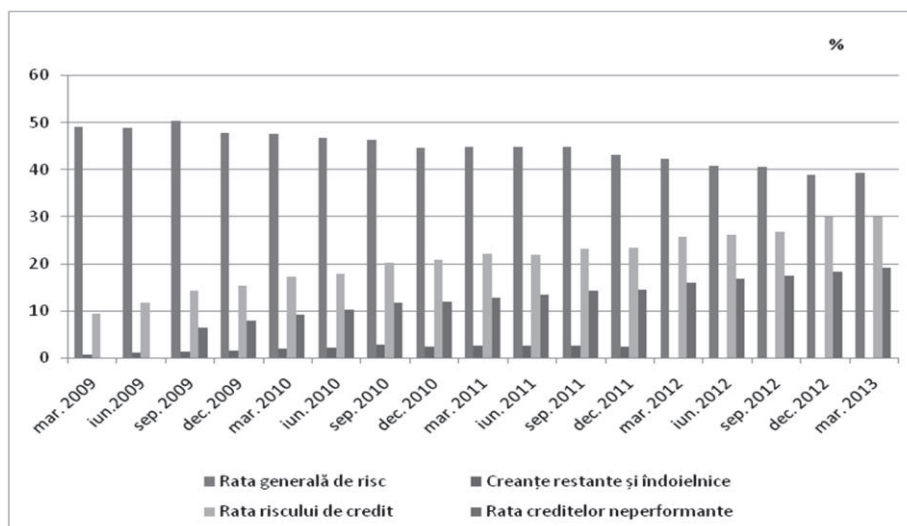


Chart 3. The evolution of most representative indicators of credit risk in the Romanian banking system in 2009-2013

The evolutions of some of these indicators, such as the non-performing credit rates, represent common developments in other European banking markets in the region (for example Slovenia, Hungary, Bulgaria, the highest level of non-performing debts was reported by Greece with 22.5 percent for 2012, 6.5 percentage points higher than the previous year) as can be seen in the chart 4.

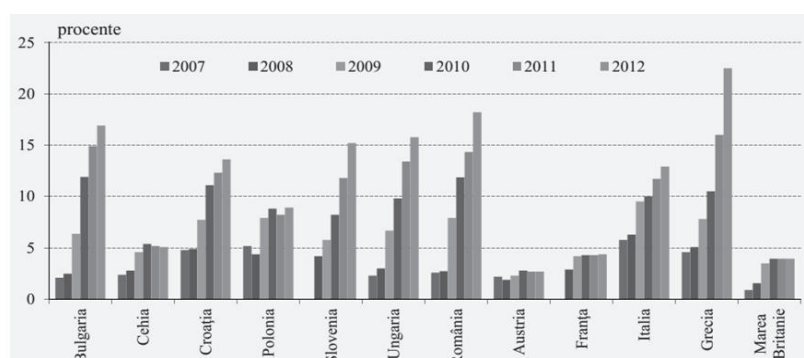


Chart 4 The quality of loan portfolios in some EU countries (non-performing loans as a share of total loans)

Source *www.bnr.ro, Financial Stability Report for 2013, p. 57*

The process of worsening the quality of the loans is the result of unsustainable increases of loan portfolio granted during 2003-2008 (period characterized by relaxing lending standards) and the difficulties recorded worldwide. Given the fact that there is no single definition at European or international level for non-performing loans, the differences in accounting standards and prudential regulations applied at national level may influence the indicator and its comparability across borders of the European Banking Authority is on the edge of materialization of the developing technical standards for reporting non-

performing exposures, which will enter into force in the next period by adding the FINREP reporting (*www.bnr.ro, Financial Stability Report for 2013*). As we already said, the risk attached to the loan portfolios can be reduced by setting up provisions, which may cover expected losses. Another tool used by the Romanian National Bank to ensure the ability of banks to absorb losses arising from credit risk, with provisions, is the capital adequacy risks. In this respect the Romanian National Bank requires maintaining comfortable levels of solvency and adequacy of the rate of personal funds of first level. At the level of the Romanian banking system for setting up the extent of provisioning, it was used for 2007-2011 an indicator calculated as the ratio between total provisions and gross exposure on loans overdue for more than 90 days and / or for which legal proceedings have been initiated. Since 2012, Romania used the indicator "the extent of covering the non-performing credits by provisions IFRS prudential filters related to this category" reviewing the adequacy of provisioning the prospect of IFRS accounting standards and prudential filters used in the calculation of its own funds (*www.bnr.ro, Financial Stability Report for 2013*).

The chart below shows the evolution of monthly values of the indicator, the coverage extent of the non-performing loans by IFRS provisions and prudential filters since January 2012. The evolution of this indicator can be appreciated as being comfortable in this period. According to the Financial Stability Report from 2013 published by the Romanian Central Bank this indicator recorded a level of 86.3 percent in December 2012 and 89.5 percent in August 2013.

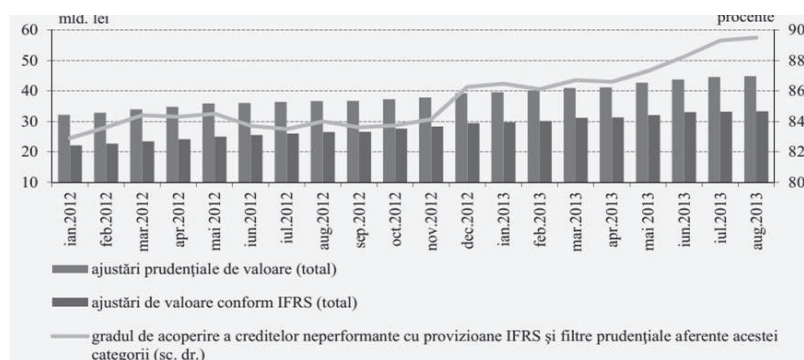


Chart 5. The coverage extent of the non-performing loans with IFRS provisions and prudential filters

Source *www.bnr.ro, , Financial Stability Report for 2013, p. 59*

Although there is no harmonization at the European level of the indicator's definition, regarding the coverage extent of the non-performing loans, we can see in the chart below that the level of provisioning calculated at the level of the Romanian banking system is higher than that reported for other countries region, such as Poland, Slovenia, Czech Republic, and Hungary. It can also be noted that the level registered by Romania is even a higher level since the main countries of origin of the major shareholders of credit institutions, Romanian legal entities, which have the status of branches of foreign banks, such as Austria, France, Greece, Italy, and UK.

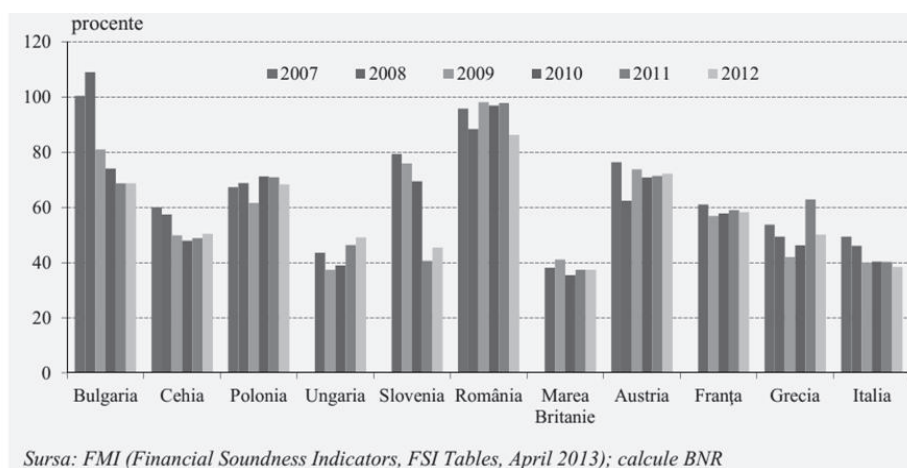


Chart 6. The coverage extent of non-performing loans in some countries of the European Union
Source: www.bnr.ro, Financial Stability Report for 2013, p. 60

The classification of the loans is an important tool of the management of credit risk and is performed periodically. Also, loan classification represents the basis for determining the appropriate level of credit risk provisions. According to the international standards the bank loans are classified into the following categories (IMF, 2006): standard, in observation, under standard, doubtful, losses. The analysis of the loan portfolio involves (Greuning, 2009): creating a summary of the main types of loans; allocating the loan portfolio based on a number of criteria such as maturity, type of client; types of accepted warranties; risks associated with loans; non-performing loans analysis etc. Taking into account the information published by the Romanian National Bank, we hereby have achieved a dynamic analysis of the structure of the loan portfolio allocated in the economy, highlighting the evolution of bad loans in 2009-2013. The analysis focuses on both structural and dynamic analysis of loans granted to the entire banking system. From December 2012 came into force Regulation no. 16/2012 of the Romanian National Bank, which classify the loans, investments and prudential value adjustments, repealing Regulation no. 11/2011, as amended and supplemented (www.bnr.ro, Monthly report 2013, p. 78). In the case of loans allocated to customers outside the credit institutions sector there have been registered from year to year an increasing credit loss from 22839.4 million lei in 2009 to 51591,6 million lei in March 2013 (see Table no. 1).

Table 1 Credits allocated to customers outside the credit institutions sector

-mil. lei-

CATEGORY PERIOD	TOTAL VALUE	STANDARD	IN OBSERVATION	UNDER STANDARD	DOUBTFULL	LOSS
2009	192.789,7	103.267,5	43.156,1	16.889,8	6.636,9	22.839,4
2010	205.651,0	96.460,3	44.147,9	22.231,7	9.088,0	33.723,1
2011	219.450,4	101.608,7	42.821,0	23.936,3	10.209,4	40.875,0
2012	210.400,9	90.861,8	33.551,6	23.056,8	13.560,9	49.369,8
Mar. 2013	209.362,5	93.255,8	31.552,7	21.787,8	11.174,6	51.591,6

Source: Data extracted from the monthly reports 2009 - 2013, www.bnr.ro

As it can be seen in the chart below, the highest value of loans is being held by standard loans, they return with safety, but this varies from year to year to increase and decrease with a lower ratio in 2012 to 90861.8 million lei. There can be observed an increase in March 2013 of 93255.8 million lei, growth that we hope will continue to stabilize the banking system. The loans from loss category are growing, evolving fairly quickly because of the instability and the inability of borrowers to pay back their loans, their

value reached in March 2013 to 51591.6 million lei, with 28752.2 million lei more than that of 2009.

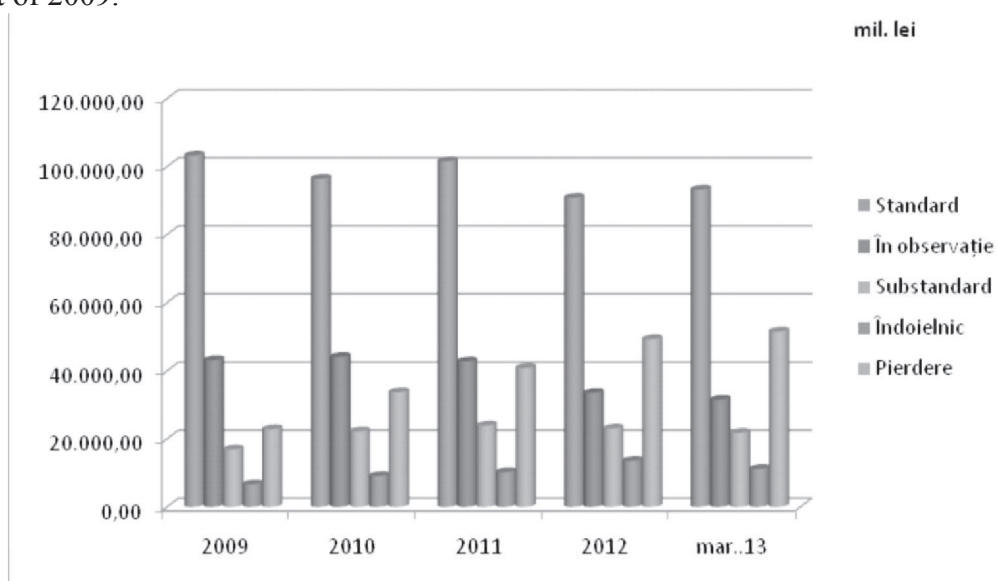


Chart 7. The evolution of the credits allocated to customers outside the Romanian credit institutions sector 2009-2013

Table no. 2 from Anexa 2 summarizes the evolving structure of the loan portfolio to customers outside the sector of credit institutions in total loans in 2009-2013. The calculations were made on the basis of the information included in Table no. 1. If we closely look at the structure of the loan portfolio in 2009-2013, we can see that the highest value is the standard type loans recorded in 2009, of 53.56%, with those in the observation with a value of 22.39% in 2009, and the loss category, registering the highest value in March 2013 to 24.64%, this fact worsened the existing loan portfolio. According to chart no. 3, during the period under review the standard loans have a declining trend from 53.56% in 2009 to 43.19% in 2012, while in March 2013 they recorded a small increase of 1.35% against 2012. Moreover, the loans included in the “in observation” category recorded a downward trend, from 22.39% in 2009 to 15.07% of total loans in March 2013. The loans included in the “losses” category have an increasing trend March 2013 reaching a share of 24.64% from 11.85% in 2009.

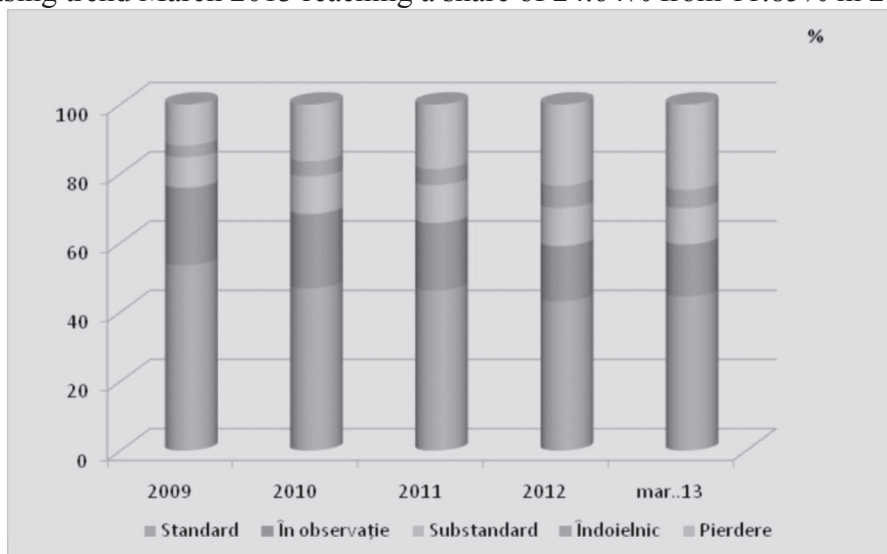


Chart 8. The share of the entire number of credits allocated to customers outside the Romanian credit institutions sector 2009-2013 in total loans

CONCLUSIONS

Romania finds itself in a constant unstable situation in terms of non-performing loans, their share increasing from year to year, moving forward from 7.9% in 2009 to 18.23% in 2012 and reaching to 19.08% in March 2013. The still fragile macroeconomic background led to an increasing volume growth of the debts of non-performing loans reported by credit institutions, but there has been ascertained a slowdown in their accumulation rhythm. According to the Romanian Financial Newspaper, Romania was ranked third among the European countries in terms of non-reimbursement of the loans allocated by the banks in 2012, local banks registered portfolios of bad loans worth to 10 billion Euro. Over time, because of the risks, banks were forced to establish provisions with huge sums of billion euro, to cover losses on non-performing loans, and this fact serious affected bank earnings, taking them in a negative area of losses, these losses reaching 475 million euro in 2012. The credit risk is present among the most dangerous risks in the bank risk category, it appeared in a wide range of exposures and hazards encountered. To successfully manage this risk a strong culture in this respect is needed. Important efforts are made in order to improve loan portfolio, but this resource is needed to bring high value risks to an acceptable level for credit.

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Table 1
Indicators of credit institutions related to credit risk

Indicators Date	General rate of risk (%)	Loans in depreciation (% of total loans)	Overdue and doubtful loans (% of total loans)	Credit rate (%) of the risk	Non-performing loans rate (%)
Mar. 2009	48,98	-	0,66	9,40	-
Iun. 2009	48,68	-	1,03	11,76	-
Sep. 2009	50,23	-	1,23	14,18	6,46
Dec. 2009	47,62	-	1,45	15,29	7,89
Mar. 2010	47,43	-	1,99	17,17	9,11
Iun. 2010	46,70	-	2,17	17,81	10,20
Sep. 2010	46,27	-	2,67	20,24	11,67
Dec. 2010	44,56	-	2,23	20,82	11,85
Mar. 2011	44,80	-	2,59	22,00	12,71
Iun. 2011	44,82	-	2,51	21,89	13,35
Sep. 2011	44,66	-	2,45	23,03	14,18
Dec. 2011	42,97	12,28	2,32	23,28	14,33
Mar. 2012	42,27	12,00	-	25,56	15,88
Iun. 2012	40,79	11,66	-	26,06	16,76
Sep. 2012	40,56	11,25	-	26,78	17,34
Dec. 2012	38,80	10,61	-	29,91	18,24
Mar. 2013	39,20	9,22	-	29,98	19,08

Source: Data extracted from the monthly reports 2009 - 2013, www.bnr.ro

Table 2

The share of the entire number of credits allocated to customers outside the Romanian credit institutions sector 2009-2013

INDICATORS	% IN TOTAL AMOUNT OF LOANS				
	2009	2010	2011	2012	Mar. 2013
Standard	53,56	46,90	46,30	43,19	44,54
In observation	22,39	21,47	19,51	15,95	15,07
Under standard	8,76	10,81	10,91	10,96	10,41
Doubtfull	3,44	4,42	4,65	6,44	5,34
Loss	11,85	16,40	18,63	23,46	24,64
Total amount of loans -%-	100	100	100	100	100