

BANKING RISKS IN THE ROMANIAN BANKING SYSTEM

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***Abstract:** Banking risks faced by the commercial banks in the Romanian banking system are multiple and complex. They are constantly monitored by the National Bank of Romania, which provides prudential supervision of banks. The analysis of credits by risk classes and its dynamic evolution highlights a decrease in the quality of credit portfolios managed by banks. From the credit risk information and the analysis of the evolution of the main prudential banking indicators, results that the main risk faced by banks is credit risk. In the banking risk management process is required the identification of some priorities, by the banks of the Romanian banking system. To ensure and guarantee soundness of the Romanian and European banking system, is required the implementation of a unique mechanism of banking supervision.*

***Keywords:** banking risks, Romanian banking system, credit portfolio, performance indicators, prudential supervision*

***JEL Classification:** G21, G28*

INTRODUCTION

Commercial banks operating in the Romanian banking system have an important role in mediating the relationship savings-investments. Their entire activity is subject to risk.

In the current context of the global economy and rapid innovation in the financial markets, the uncertainty degree has increased and the specific banking risks have multiplied. In the banking environment risk is inherent and inevitable. To reduce risk exposure, banks are creating a strategy for identifying, quantifying and continuous monitoring risk exposures.

The main objective of bank management is represented by effective risk management to achieve financial performance.

In this context, The National Bank of Romania, as a supervisory authority, has the role of ensuring the prudential supervision of banks. This is accomplished by assessing the risk structure of bank assets and by establishing the corresponding value of capital and available reserves necessary to guarantee the solvency of banks.

At European level, is prepared the implementation of the unique mechanism of banking supervision. It will be composed of the European Central Bank and the National Banks of the member states of the European Union. The main objectives of the unique supervisory mechanism will be:

- enhancing the safety of the European banking system soundness;
- increasing integrity and financial stability in Europe.

This research aims to analyze the evolution of the health of the Romanian banking system, in terms of its exposure to risk. The main risks subject to the analysis are the ones monitored by the National Bank of Romania and quantified throughout the Romanian banking system.

In the literature review, the subject about banking risks is treated in extension. It reveals the impact of the financial crisis on bank run risk, the relationship between liquidity risk and credit risk in banks, the systemic risk and bank consolidation, the relation between risks and financial performances in banks.

MATERIALS AND METHODS

The research methods used are: analysis, synthesis, induction and deduction. The banking risk indicators analyzed in this research are those monitored and reported by the National Bank of Romania. The time horizon in which are analyzed the banking risk indicators and prudential banking is the period 2011 - January 2014. For the analysis of the credit portfolio of commercial banks, were quantified the five risk classes, namely:

- standard;
- in observation;
- substandard;
- doubtful;
- loss.

Credits are classified by banks into five risk classes, according to:

- debt service;
- financial performance of the borrower;
- initiation of judicial proceedings.

Framing in a single classification category is made based on the principle of rating downgrade by contamination, respectively by considering the weakest classification of individual categories.

The entire Romanian banking system, the classification of credits by risk classes, at the end of January 2013 and January 2014, is presented in the table below:

Table no. 1
Classification of credits on risk classes

– million lei –

Volume of credits	Period	
	January 2013	January 2014
Total credit, of which, classified at:	208066.9	195532.2
Standard	92194.0	84422.3
In observation	30597.2	29022.5
Substandard	22482.9	18441.5
Doubtful	13141.2	9239.2
Loss	49651.6	54406.7

(Source: BNR – Monthly Bulletin, no. 1/ 2014, Statistics Section, pp. 55)

From the table above it can be observed that the volume of credits on total banking system has diminished by 6.2% in January 2014 compared to January 2013. In these conditions, low quality credits qualifying in loss category increased by 9.58% over the same period. This situation highlights a decrease in the quality of credit portfolio managed by Romanian commercial banks. Good quality credits, qualifying in standard category decreased in volume by 8.43%, which exceeds by 2.41% the decrease of the total credit volume of 6.02% during the analyzed period.

Behold then, that in terms of the reduction of the volume of good quality credits (standard), the volume of low quality credits (loss) increased during the analyzed period, which shows a decrease in the quality of the credit portfolio of the Romanian banking system.

According to NBR Regulation no. 16/ 2012 and NBR Order no. 15/ 2012, credit institutions, Romanian legal entities and branches in Romania of banks from third party states, for credits and investments they hold, determine the minimum capital requirements for credits risk. They are determined individually, using the standardized approach.

The methods of quantifying the main prudential banking indicators took into account the provisions of NBR Order no. 22/ 2011 and the NBR Regulation no. 25/ 2011. Since January 2012, prudential banking indicators are calculated according to reports prepared in accordance with IFRS standards. Starting with January 1, 2012 entered into force NBR Regulation no. 2/ 2012 regarding the organization and functioning of the Central Credit Register.

By analyzing the banking risk management process, respectively: identifying, measuring and monitoring them, we can identify the following priorities:

- rigorous organization and regulation of the banking activity;
- providing a personnel structure for banks highly skilled and experienced;
- establishing some efficient banking policies and strategies;
- implementing advanced information systems.

The banking risk management process is presented as in the following figure:

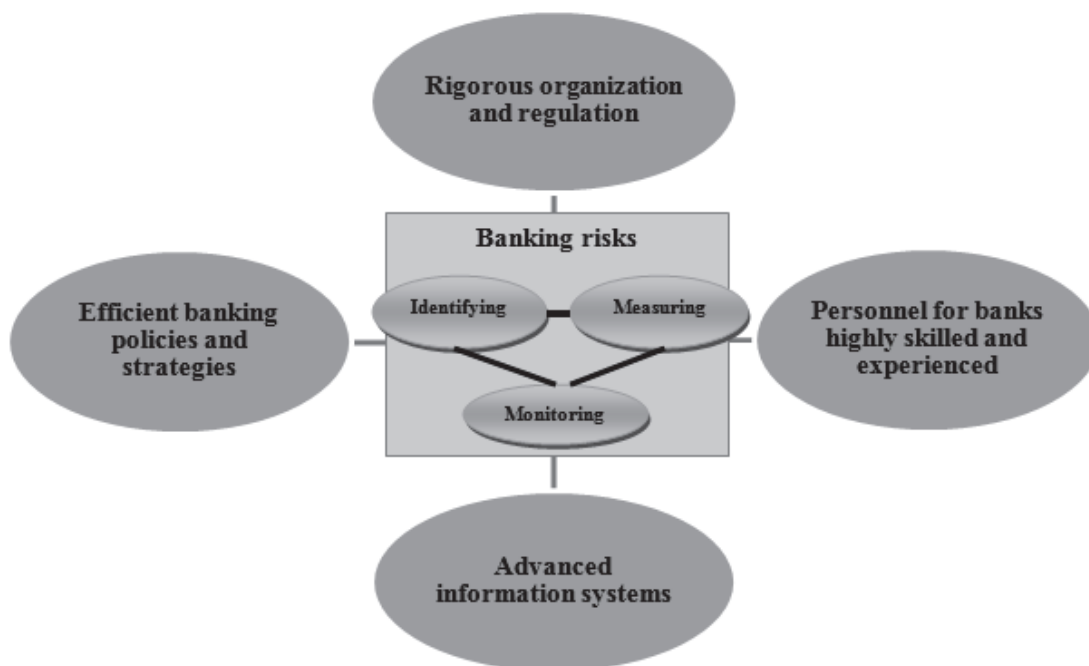


Figure no. 1. Banking risk management process

Credit risk should be viewed as a complex of events with negative consequences for the bank.

Risk exposure may cause losses or additional expenses for the bank. The main cause of losses and insolvency of banks is the difficulty to cope with events that may occur, but have not been foreseen.

RESULTS AND DISCUSSION

In analyzing banking risks an important place is occupied by the analysis and evolution of the main prudential banking indicators, namely:

- solvency indicator;
- general risk ratio;
- credit risk rate;
- rate of nonperforming credits;
- liquidity indicator.

The evolution of the main prudential banking indicators during the period 2011 - January 2014, is presented in the table below:

Table no. 2
Evolution of the main prudential banking indicators

(%)

Indicators	Period			
	2011	2012	2013	January 2014
Solvency indicator ($\geq 8\%$)	14.87	14.94	15.02	X
General risk ratio	42.65	38.80	35.85	X
Credit risk rate	23.28	29.91	32.14	32.55
Rate of nonperforming credits	14.33	18.24	21.87	22.31
Liquidity indicator	1.36	1.42	1.53	1.47

(Source: BNR – Monthly Bulletin, no. 1/ 2014, Statistics Section, pp. 56)

From the table above it is observed that the solvency indicator has a positive evolution during the period 2011-2013, from 14.87% in 2011, to 15.02% in 2013. For the solvency indicator the minimum regulated level is 8% since 2007, in terms of implementing Basel II requirements in the national regulatory framework.

The general risk ratio for total banking system registers a positive evolution in the sense that it diminishes from 42.65% in 2011 to 35.85% in 2013.

However, the credit risk rate registers a negative trend. The credit risk in total banking system increases from 23.28% in 2011, to 32.14% in 2013. Credit risk rate is determined as a ratio between gross exposure of credits and interest classified under “doubtful” and “loss” and total credits and interest classified for non-banking credits, excluding elements off the balance sheet.

The rate of nonperforming credits also registers a negative evolution. The nonperforming credit rate increases from 14.33% in 2011, to 21.87% in 2013 and to 22.31% in January 2014. The rate of nonperforming credits represents the main indicator for assessing the quality of credit portfolios of commercial banks, in a prudential perspective. It is calculated based on prudential reporting regarding the classification of credits. As volume of the remaining credit it is taken into account the entire balance of the credit and the related interest, regardless of the number of outstanding installments.

The results registered in the evolution of credit risk rate and the nonperforming credit rate during 2011-January 2014, lead to the conclusion of the degradation of the credit portfolio managed by Romanian commercial banks.

In the table above the liquidity indicator is expressed in units. This prudential banking indicator is calculated by banks according to NRB Regulation no. 25/ 2011 regarding the liquidity of credit institutions. The indicator is calculated as a ratio between the effective liquidity and the necessary one, on each maturity band (up to 1 month, between 1 and 3 months, between 3 and 6 months, between 6 and 12 months and over 12 months). Banks must maintain permanently the liquidity indicator at least at 1 for maturity bands up to 1 month, between 1 and 3 months, 3 to 6 months and between 6 to 12 months.

The results recorded in the evolution of the liquidity indicator are positive. It increases from 1.36 in 2011 to 1.53 in 2013, reflecting an effective liquidity higher than the one required in commercial banks of the Romanian banking system.

In its reports, which cover the entire banking system, the National Bank of Romania also presents credit risk information. For credit institutions, these credit risk information mainly target the following elements:

- total amounts due (global risk);
- outstanding credits;
- total number of borrowers with overdue repayments and related interest;

- number of registrations to the Central Credit Register's database, and others.

The main credit risk information, reported by the National Bank of Romania, is presented in the following table:

Table no. 3
Credit risk information

Credit risk information	Period			
	2011	2012	2013	January 2014
Total amounts due Global risk (million lei)	257575	262811	256842	257908
Total outstanding amounts	19911	27577	31529	32179
Number of borrowers (individuals and legal entities)	962814	932319	899723	896768
Number of borrowers overdue	224583	231396	214038	215093
Number of queries of the Central Credit Register's database	143968	128014	131421	139635

(Source: BNR – Monthly Bulletin, no. 1/ 2014, Statistics Section, pp. 57)

These credit risk information presented in the table above refer to the exposure of a single borrower, exposure equal or higher than 20000 lei. Credit risk information includes the identification data of a borrower, the individual or legal entity, as well as operations in lei or foreign currency through which the declared persons expose to risk towards that borrower. Risk exposure targets both granting credits and assuming commitments by the person declared in the name of the borrower.

From the credit risk information presented in the table above, results that the total amounts outstanding increased from 19911 million lei in 2011 to 32179 million lei in January 2014, so with 61.62%. This increase of the amounts outstanding, by 61.62% during the analyzed period, is achieved in the conditions in which the total amounts due remains approximately equal (the increase being only 0.13%). The negative evolution of this credit risk indicator, respectively total outstanding amounts, reflects the difficulties faced by banks in the Romanian banking system in recovering the granted credits.

The decrease of the number of debtors, individuals and legal entities, by 6.86% during the analyzed period reflects the increased indebtedness degree; given that the total amounts due remain approximately equal.

The results of the analysis performed on credit risk information, presented in this research, lead to the conclusion that commercial banks in the Romanian banking system are experiencing difficulties in managing their credit portfolios.

CONCLUSIONS

This research, aiming at banking risks in the Romanian banking system, reveals the fact that commercial banks within the system are facing multiple and complex risks.

Ensuring safety soundness of the Romanian and European banking system requires the implementation of a unique mechanism of banking supervision.

Analyzing the dynamic evolution of credit classification on classes of risk, it can be observed an increase in the volume of low quality credits, qualifying under "loss" category, which highlights degradation in the quality of credit portfolios managed by banks.

Considering credit portfolio quality and the main prudential banking indicators, respectively: credit risk rate and rate of nonperforming credits; they have a negative evolution during the analyzed period. This highlights the difficulties faced by banks in

the Romanian banking system, despite the fact that they have managed to maintain the solvency and liquidity indicators at positive parameters.

From the analysis of credit risk information results a negative evolution of the indicator “total amounts due”, its increase reflecting difficulties faced by banks in recovering credits.

The quality of the credit portfolio provides an immediate picture of the health status of a bank, while the structure of credit portfolio provides a perspective image on the health status of a bank and allows preventive interventions in the plan of policy banking measures to resolve a possible crisis. It can be considered that the immediate or imminent credit risk taken by a bank is given by the quality of the credit portfolio. If we look ahead, we can speak of a potential credit risk, highlighted by the structure of the credit portfolio.

In conclusion, it can be appreciated that from the category of banking risks faced by the Romanian banking system, the most representative is credit risk. It is constantly monitored by the National Bank of Romania, both in the prudential banking indicators and in framing credit risk information.

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