THE ANALYSIS OF THE CREDIT RISKS IN THE BANKING ACTIVITY

Apetri Anişoara Niculina

University "Stefan cel Mare" Suceava, Faculty of Economic Studies and Public Administration, Universitații Street , nr.13, Suceava 720229 , Romania, e-mail: anisoarad@seap.usv.ro, Telephone: 0330-101130, 0230-522978 interior: 314

Abstract: We could say that banking risk is a phenomenon which appears during the banking operations and which induces negative effects to those activities by the deterioration of the business' quality, the elimination of profit and even losses are registered. In this paper I shall present in short the way in which the financial and nonfinancial analysis is made in the Romanian banking system, as instruments of quantification of the credits risks and as a way of managing it.

Whatever the level of the taken risks the loss can be minimized if the creditation operation are organized and managed in a professional way.

Keywords: the crdit risk, the financial performance, the SWOT analyses, asset classification.

The banking risk can be provoked inside the bank by clients or by the external competitive medium. The conditions which lead to the emergence of the banking risks are determined by the manifestation of a complex of factors which depend on:

- the general evolution of the economy;
- changes connected to the structure of the bank;
- the political and economical conditions.

The analysis of the banking risks implies, first of all, the complete onset of the main categories of inner risks like: the lending risk, the liquidation risk, the credit solvency risk, the interest rate risk, the currency risk. The analysis of the inner banking risks is completed by the evaluation of the external risks, like those associated with the delivery process of goods and services (technological risk, product risk) or with the business medium (the competition risk, the settlement risk) on which the banks have a limited control.

There are a lot of banking risks and they are multidimensional and they have to be grouped and defined as well as possible in prospects of meaning, pursuing and controlling them. The management of risks and the management of the assets and passives which address first of all, to the quantifiable risks as:

- the financial risks connected to the variation of the rate of interest, the risks connected to the insurance of liquidities and the risks of losses in funds operations;
- the credit risk which expresses the losses caused by the impossibility of the clients to acquit the obligations to the bank, this being considered to be a commercial risk emerging from choosing the friends and clients.

The bank has a purpose the quantification of risk, using international known methods, procedures and techniques, taking into consideration the main elements like:

- The client's financial performance;
- The structure of the assets or of the made investments;
- The quality and structure of the refund source;
- The quality and structure of the guaranties.

The quantification analysis of the risk of the credit has as a purpose the knowledge about the client's evolution in the past periods and the prognosis about his future performances, so that we could make a prognostic on his viability.

The analysis of the quality and the classification of the credit portfolio are made considering the evolution of the lent person's financial performances, as well as his debt service and his ability to honour his debts in time.

The framing of the economical agents in one of the five categories of the financial performance marked from A to E is made on the basis of the financial analysis of the data provided by the accountant documents solicited from the bank's client's. This thing allows the assignment of a scoring to the quantificable criteria, which then corroborate with the analysis results of the unquantifiable criteria, that is to say the nonfinancial analysis. Following the analysis of the financial performance according to the main liquidity indicators, solvency, capitalization and the debts service, the credits are classified: standard credits, under observation, under standard, questionable and loss. The main used method of nonfinancial analysis in the SWOT method (strenghts, weaknesses, opportunities and threats).

Following the classification of the credits in order to limit the risks in the crediting activity and the keep to minimum level of solvency, the banks constitute peculiar victuals of risk besides the general reserve of the credit risk. This is made by the application of a percent on the balance on current account of the given credits. They also have recourse to the cession of the risks by striking assurances with specialized institution in order to cover the risk of loss to the credits portfolio.

When giving credits, the banks take care that the solicitors present credibility for their payment at the dead line. All banks analyze the reliability of their clients and ask the guarantee of the credits in the conditions established by the credit laws. For limiting the credit risk, the central bank can establish the following rules:

- limitation of the credit for one debtor.
- limitation of large credits
- provision making

The Romanian norms establish that the credits given by a bank to one sole debtor cannot pass 20% of their own funds. Moreover, there are restrained the credits given to persons that have special relations to the bank. For instance, the amount of credits that can be given by a bank to their stock holders is of minimum 20% of its own funds.

According to the careful norms of BNR the total amount of the big credits given to the debtors cannot overpass 8 times the level of the company's own funds. The big credits can be given only upon a decision taken in unanimity by the Committee of Directors, and the amount must be communicated by BNR.

The credit risk can be defined as the interest risk, the credit or both not being paid back at falling due or partially reimbursed. The incapacity to reimburse the credit can come from some internal factors of the company, as:

- quality and morality of management;
- the company's incapacity to adapt to the market;
- the time in which the debentures from the beneficiaries can determine financial blockages and therefore production troubles in the company's activity.

The credit risk management implies:

Preventing the risk that has 2 aspects: dividing the risk that has as objective the dissipation of risks so that the law of probabilities reduces the possibility of some losses and the constitution of some guarantees that must be seen as a subsidiary insurance, the decision to give the credit being taken according to the possibility of credit reimbursement that results from the analysis on the business that the bank is crediting.

The measurement of the risk is done in 2 stages. The first one is the establishment of some maximum limits of the risk assets compared to the own funds of the bank by recalculating the solvability rate (COOK norm). The second step is the measurement of the risks to which the bank is exposed by the periodical evaluation of the credit portfolio. The measurement of the credit risk in order to constitute the risk provisions imposes the evaluation of the financial performances of all bank clients based on their balances.

a) The duty service (client's capacity to fulfill their duties at falling due). This might be:

- good - if the rates and interests are paid on falling due with a delay of maximum 7 days
- poor, if rates and interests are paid on falling due with a delay of up to 30 days
- inadequate - if rates and interests are paid on falling due with a delay of more than 30 days

b) The financial performance (evaluated based on some criteria established by each bank). The financial performance reflects the economic potential of an economic entity obtained after the analysis of an assembly of economical and financial indicators (cash, solvability indicators, benefit mini indicators, activity indicators) calculated based on the data from the annual financial situations, through which one appreciates the client's financial reliability. Besides the financial standing indicators analysis, the qualitative factors are also used for the appreciation of the financial performances: the company's management quality, marketing policy - competence, market position, distribution and other aspects related to the credit history and the stock holder quality.

The performance is calculated based on some points by giving them for each analyzed aspect, calculating an average of the quantity component and one for the quality component.

After the evaluation of the financial performances of the clients, the credits will be enclosed in one of the following categories:

- A category or Standard credits
- B category or In observation
- C category or Substandard
- D category or Doubtful
- E category or Loss

For individuals, the classification of the portfolio of credits is done according to the duty services.

c) Initiating the legal procedure

3. The actual management of the risk lies in the use of some techniques as the revision of credits through which the bank can lesser or eliminate the losses or can save the credit.

The revision of credits, besides reducing the losses, allows the solving of some other problems as:

- ensure the uniform application of the credit documents
- verifies if the credit politics, bank's norms and bank norms are respected
- the information of the bank management about the credit portfolio situation.

Another salvation technique is the debenture sale by bank of a trusty bank that takes care of the debenture forfeiture, transforming them in money for a commission.

Credit risk is the most common cause of bank failures, causing virtually all regulatory environments to prescribe minimum standards for credit risk management. The basis of sound credit risk management is the identification of existing and potential risk inehrent in landing activities. Specific credit risk management measures typically include three kinds of policies:

- policies to limit or reduce credit risk;
- Policies of asset classification;
- Policies of loss provisioning, or the making of allowances at a level adequate to absorbed anticipate loss not only on the loan portfolio, but also on all other assets that are subject to losses.

Policies to limit or reduce credit risk. Bank regulators have traditionally paid close attention to risk concentration to banks. A regulator‘s objectives in credit risk management is to prevent banks from relying excessively on a large borrower or group of borrowers, but not to dictate to whom banks may or may not llend.Modern prudential regulations usually stipulates theta bank not make investments, grant large loans, or extend other credit facilities to any entities in excess of an amount that represents a prescribed percentage of the bank's capital and reserves.

Most cou8ntries impose a single-customer exposure. The Basel Committee on Banking Supervision has recommended a maximum of 25 percent, with intention to reducing it as soon as this is practical.

Lending to connected parties is a particularly dangerous form of credit risk exposure. Related parties typically include a bank's parent, major shareholders, subsidiaries, affiliate companies, directors and executive officers. Most regulator establish limits for aggregate lending to related parties, typically stipulated that total lending to related parties cannot exceed a certain percentage of tier 1 or total of qualifying capital. A prudent banking practice wood requires all loans to related parties to be approved by the board.

Asset classification is a key risk management tool, a process whereby an asset is assigned a credit risk grade, which is determined by the likelihood that debt obligations will be serviced and debt liquidated according to contract terms. Assets are classified of the time of the origination and than reviewed and reclassified is necessary a few times per year.

Assets classified as “pass” or “watch” are typically reviewed twice per year, while critical assets are reviewed at least each quarter.

Standard rules for asset classification that are currently used in the most developed countries, according to the international standards, are:

Standard or pass. Loans and other assets that are fully secured by cash or cash substitutes are usually classified as standard regardless of arrears or other adverse credit factors.

In some advanced banking systems, banks use more than one rating level for assets in the pass category. The objective of such at practice is to improve the quality of portfolio analysis and trend analysis to be able to better differentiate among credits of different types, and to improve the understanding of the relationship between profitability and the rating level.

Banks engaged in international lending face additional risks, the most important of which are country, or sovereign, and transfer risks. The former encompass the entire spectrum of risk posed by the macroeconomic, political and social environment of a country that may affect the performance of borrowers. Transfer risks are the difficulties that a borrower might have in obtaining the foreign exchange needed to service a bank’s loan.

Specially mentioned or watch. In this categories are includes:

- Credit given through on inadequate loan agreement, a lack of control over collateral, or without proper documentation.
- Loans to borrowers operating under economic or market conditions that may negatively affect the borrower.
- Borrowers with of adverse trend in their operations or an unbalanced position in the balance sheet.

Substandard. This classification indicates well – defined credit weaknesses that jeopardize debit service capacity , in particular when the primary source of repayment are insufficient and the bank must look to secondary sources for repayment, such as collateral, the sell of the fixed asset, refinancing, or fresh capital.

*Doubtful.*Such *a*ssts have the same weaknesses as substandard assets, but their collection in full is questionable on the basis of existing facts. Nonperforming assets that are at least 180 days past due are also classified as doubtful, unless they are sufficiently secured.

Loss. This classification does not mean that an asset has absolutely no recovery or salvage value, but rather that it is neither practical nor desirable to defer the process of writing it of, even through partial recovery may possible in the future.

Loan Loss Provisioning Policy

Assets classification provides a bases for determining an adequate level of provisions for possible loan losses.. Such provisions, together with general loss reserves that are normally counted as tier 2 capital and are not and are not assigned to specific assets, form the basis for establishing a bank’s capacity to absorb losses. The established level of mandatory provision is normally determined by certain statistics. In countries where the legal framework for debit recovery is highly developed, such as the United States, studies have demonstrated that approximately 10 percent of substandard assets eventually deteriorate into loss. An analysis of adequacy of the overall allowance for losses should include the following aspects:

- A survey of the bank’s existing provisioning policy;
- An overview of asset classification procedures and the review process, including the time allotted for review;
- Any current factors that are likely to cause losses associated with a bank’s portfolio and that differ from historical experience of loss;
- Trend analyses which service highlight any increases in overdue loans and the impact of such increases;

– An opinion of the adequacy of the current policy and. On the basis of the loans reviewed extrapolation of additional provisions necessary to bring the bank's total loan-loss provision to a level in line with International Accounting Standards (IAS).

At present, the risks represent an ever more increased role in the bank management activity, and without a corresponding identification and prevention policy applied to them the bank can be exposed to certain situation of an utmost gravity.

Any economical activity involves a risk, but in the case of the banks, the dictum "risk is my job" fits like a glove because, indeed, what could be more risky than to collect money available from the market and to lend it to various clients-physical and juridical persons- for long periods of time, being mainly based on promises and provisions regarding the business/audited project and less on the collaterals (non-cash) which are either insufficient., or very hard or even impossible to be recovered.

The quantification of the risk and the company uncertainty, as well as the determination of the influences that they have over the economical phenomena, represent a permanent problem for the decision factors which coordinate the activity in companies.

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