

# THE ANALYSIS OF THE RISKS AND OF THEIR EFFECTS UPON THE BANKING ACTIVITY

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*Abstract: The double role of the banks, independent economically entities, having as objective the maximisation of the profit, in the condition of minimizing the risks, on one hand, and of elements of the banking system, coordinated by the central bank, having as objective the implementing of its monetary policy, on the other hand, involves a new dimension of the risk, meaning that the policies carried out by the banks in order to achieve their personal object of activity, may be contradictory with the monetary political measures assessed by the central bank, at a certain moment.*

*KEYWORDS: banking risk, financial decision, solvability, liquidity, crediting risk, the indicators;*

## 1. The banking risks

The appearance of the banking risks is established by the manifestation of a complexity of factors, which are referring to: the general evolution of the economy, changes in the organisation of the bank, financial decisions, the economic and politic conditions. *The general evolution of the economy* induces modifications of the macro-economical indicators with an impact upon the banking activity. Definitely, a high rate of inflation indicates certain economic lack of balance that severely affects the results of the banking activity on a short term and implicitly causes a medium and long term increment to all categories of banking risk. The dependence of the real instalments of the interest by the inflation rate and the implications that the interest is having upon the level of the resources and investments of a bank that's operating in a competing environment, as well as upon the bank profits, induces the existence of a direct proportional relation between the level of the inflation and the level of the banking risks.

*The problems in organising a bank* is a matter of management, and the organisational solutions solved by the bank's management are close related to the quality of the leaders. An inefficient systematisation is definitely a management error which influences badly the whole ensemble of the bank's activity. In a developing banking system, as it is the one in our country, one of the major deficiencies is the lack of the experienced managers, as well as the operative stuff, generally picked from the non-banking economy. The training of the stuff and the specializing in the peculiar area of the banking activities are the components of an efficient long term bank policy. The risks resulting from the problems related to human resources are attenuated by the realistic policy carried out in this area.

*The taking of a financial decision* undergoes certain risks, the sources of which are residing in the non-banking and/or banking economical environment, as well as from the inside of the bank, in the last case being involved the human factor. Paraphrasing Albert Camus, the bank managers can't make a decision without the risk of loosing something.

*The existing and future political and economical conditions* of the country have effects upon the service of public duties. The inter-conditioning between the economical and the political generates, on a long term, positive or negative tendencies that leave a certain imprint upon the image of the country in the world. The quantifying of the country risks is performed by taking into account these tendencies, affecting in this way the external banking operations. In a concrete way, the external financing activities, performed through banks or through the credit lines sustained by the foreign banks, through an autonomous bank, are conditioned as far as the interest terms, the securities or the reimbursement conditions are concerned, by the risks evaluated by the financing persons, taking into account, in the first place, the country risk and only then the bank risk – established through the assessment of the patrimony and through the calculation of the indicators for the economic-financial output.

## 2. Quantification of the banking risks

During the analysis of the banking risks, a special importance is given to their quantification, according to a system of specific indicators, allowing the statistic and dynamic evaluation of the risks, by reporting to the international standards or to the personal historical experience of the bank. The measuring of the risks is directly related to the one of the incomes (because, for obtaining profit, a bank has to overtake certain risks). As a consequence, the risk indicators are more relevant in a general evaluation context of the profitability of the bank and of its compatibility on the market, the final objective of the banking management also consisting in maximising the incomes of the shareholders, adjusted with the influence of risks.

## 3. The indicators for measuring banking risks

The specialised literature approaches the theme of the indicators for measuring banking risks, proposing different associated variables, usually, to the main risk categories. In the practice of the Romanian banks, there were confirmed, for the quantification of the internal risks, the following traditional indicators:

1. The indicators of the crediting risk;
2. The indicators of the liquidity risk;
3. The indicators of the solvability risk;
4. The indicators of the interest rate risk;
5. The indicators of the currency exchange rate risk.

1. Almost all the banks, at a smaller or higher level, overtake *the crediting risk*, what supposes the necessity of the attemptive analysis of the way in which the quality of the credits portfolio evolves in time, with a special impact upon the profitability, the adequacy of the capital and upon the general trust in the respective bank. As a consequence, two reference indicators for the estimation of the crediting risks are established according to the percentage of the weak quality which delays or do not allow the accomplishment of the anticipated incomes, respectively:

- the volume of the overdue credits/total credits \*100
- the volume of the non-performed credits/total credits \*100

Of course, the optimal is represented by the minimal values of the two indicators, tending towards zero, in the first case, and in the second one, the overdue credits, but especially the non-performment ones, blocking the activity and the financial results of the bank. Other indicators of the crediting risks use in the calculus formula of the reserves also the commissions constituted by the banks for covering the eventual losses, such as:

- reserves for credits losses/total credits \*100, report expressing synthetically, the managerial expectations concerning the evolution of the quality of the loans portfolio;
- commissions for credits losses/net losses \*100, report reflecting the prudence level adopted by the bank in its crediting policy;
- gross profit/commissions for credits losses \*100, respectively the cost for covering the crediting risk overtaken by the bank.

The potential measuring indicators of the risk that may signalise in advance the variations of the incomes of the bank are: the geographical concentration and on economical sectors of credits, the accelerated growth rhythm of the volume of credits, the increased profitableness of certain categories of credits.

2. Because of the informational limits of the cash-flow system, the banking analysts use a series of indicators for measuring *the liquidity*. Obviously, the more cash or banking assets the bank disposes, the bitterer its ability to face the requests for withdrawing the deposits, as well as the eventual delays in reimbursing the credits. The commercial banks normally keep between 20 and 30% from deposits in the form of liquid funds. The main indicators calculated by the treasury and analysed for assessing the liquidity are:

- global liquidity reflecting the possibility of the patrimonial active elements to be transformed on short term in liquidities, for satisfying the exigible payment obligations;

- the immediate liquidity (treasury), reflecting the possibility of the patrimonial elements of the treasury (cash, account current of BNR) to face the short term debts;
- the liquidity in accordance with the total of the deposits, reflecting the possibility of the patrimonial active elements to face the debts representing the total of the deposits and of the loans.

The treasury also establishes the exposure of the bank in accordance with the current deposits and total deposits (respectively the report between these ones), expressing the evolution tendency of the deposits on term, in comparison with the ones of the current availabilities with influence upon the stability of the resources and the level of costs.

Other indicators calculated for estimating the liquidity risks are:

- The position of the liquidity, indicator derived from the practice of the treasury management, calculated on days, weeks and months, and the optimisation of which consists in the balancing of the liquid assets with the immediate passives. In case of a negative position, the liquid assets are insufficient for fully paying the obligations, the bank having to appeal to urgent financing sources, such as: loans on interbanking market, loans from the central bank or the liquidation of certain portfolio assets before term. If the position of the liquidity is positive, the exceeding of liquidity (over the admissible limit) is placed on short term in the deposits on the interbanking market.
- The net passives, respectively the difference between assets and passives, classified in accordance with the due term, indicator calculated for signalling the period for the maximal need of liquidity. The simple net passives (successive) are established on each period, as a difference between the assets and the passives with the same deadline. The cumulated net passives are established as difference between the cumulated passives and assets, corresponding to each period of time;
- The liquidity parameter, representing the report between the sum of the passives and the sum of the assets, both pondered with the average number of days or with the current number of the respective due term group. If the liquidity parameter is:

=1, then, the bank does not have to make deadline transformation;

< 1, the bank makes the transformation from short time passives in long time assets, in the conditions of an increase curve of the interest;

>1, the bank transforms the long time passives in short time assets, resulting the liquidity risk.

- The liquidity rate expresses the evolution of the indebteding degree of the bank towards the monetary market. This is calculated periodically, in accordance with the due term of the loan operations, in the view of the formula: new contracted loans/overdue loans in the same period \*100. A supra-unitary rate indicates the decrease of the liquidity because of the increase of the indebteding degree, the relation being inversed in case of a sub-unitary rate;
- The report total credits/total deposits reflects the proportion between the resources attracted from the depositors, loaned to other clients. The biggest part of the credits is liquid.

The traditional measures of the liquidity risk generally tend to concentrate upon the liquidity of the assets in the balance sheets. In this context, we consider that it would be useful the introduction in practice of the indicators more directed towards the relationing of the actual flows or cash potential with the needs. For example, the weight of the volatile resources may suggest the liquidity needs of the bank and the percentage used by this one from its crediting reserves.

**3. The adequacy of the capital – *the solvability*** – permanently constituted an essential preoccupation of the banking management and of the regulations in the profile, because of its signification concerning the solidity of the bank and the safety of the deposits. More than that, the adequacy of the capital has also an important competitive dimension, the banks being capitalised, being more attractive for the resources, either from deposits, of from loans, in favourable conditions.

**4. *The risk of the interest rate*** is measured, in a traditional way, either through report between the assets and the passives sensible to interest, or through the difference between these ones. One of the problems raised by such a practice refers to the difficulty in selecting the due term to be used as a criterion for sensibility, the preoccupation that the reinvestment of the modification of the rates may rapidly and

quantifiably influence the sensibility to interest and the failure in appreciating the value sensibility to the modification of the rates. The more advanced indicators of the interest rate risk include the measuring of the gap, on different due terms, the dynamic measuring of the gap according to certain reinvestment estimations and rates, the measuring of the duration for the assets of the bank, the passives and the elements not included in the balance sheets.

- The risk of the interest rate, established as a report between the productive assets and the interest carrying passives (the standard level being 1);
- The absolute difference of the banking interest expressed through the net incomes between the interests reflects the ability of the bank to cover the expenses with the interest benefited at the deposits, certified by the deposit etc from the incomes obtained by cashing in the interests at the afforded credits. The interest difference has to be established in a way in which it may assure the sustaining of the banking duty (the difference between other banking expenses and other banking incomes), as well as the obtaining of a satisfying profit.
- The gross percentage difference of the banking interest, resulting from the reporting of the absolute difference to the productive assets \*100. Correlated with the level of the active/passive interests, practiced by the bank, but also with the volume accomplished by credits/deposits. A standard level of this indicator is comprised in the interval 3-10%.
- The net percentage difference of the banking interest is calculated as a report between the average level of the active interest rate and the average level of the passive interest rate \*100.

The management of the financial risks affords a special attention to the interest rate risks, related with the currency exchange one, on short term, when there are parity conditions. In practice, the banks use simulations for analysing their exposure to the interest rate risks, determining the impact of certain modifications in the interest rates on different categories of due terms, upon the profitability and the market value.

**5. the currency risk** is framed by the specialists in the category of the market risks, being established by the variations of the currency exchange rates, the deficits of the payment balances, the liquidities penury on an international plan. This risk is amplified for each participant to the development of an external payment transaction. The measurement of this type of risk is accomplished according to the position of the commercial banks, which establish an operation ceiling, in accordance with their own standing. The bank with debts upon its payment engagements, in a certain type of currency, takes a long position if there is a high probability for that currency to enter an appreciation process. On the contrary, the bank takes a short position, because of the economical context in which they act, the Romanian banks prefer the long positions, irrespectively of the currency exchange rate.

The indicators of the currency risk calculated by the commercial banks are:

- *the individual currency position* is established on each currency that is going to be administered;
- *the global currency position*, representing the net balance of the debts in estimates in comparison with the passives in estimates, both transformed in the reference currency for being compared; this indicator offers a general image upon the currency exposure of the bank.

The indicators used for the quantification of the different categories of risks generally respond to certain informational needs in the analysis and management process of the banking risks.

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