

BANK RISKS AND PERFORMANCE

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The quality of warranties is appreciated based on the extent to which these warranties can cover the credit, as well as on their nature and legal character. Depending on the nature of the warranties, each bank takes into account their own percentages in appreciating the value of the warranties, according to their own crediting rules. This has resulted in a distortion of the value of the goods used as warranty, as each bank, depending on its own crediting policy, would under-valuate or over-valuate the value of the spinoffs.

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Following the assessment of the financial performances of the customers, the latter are included in several categories that don't always remain the same; they change depending on the evolution of the economic environment, the status of the economy, and the customers' situation.

The financial performance categories used to group customers into the following groups:

- Standard - A category – it includes the customers whose economic and financial performances are very good and allow the payment in due time of the interests rates and instalments, also forecasting a future maintenance of the financial performances at a high level.
- Under observation - B category – it includes customers whose financial performances are good or very good, but who can't maintain this level of their situation in a long term perspective;
- Sub-standard - C category – it brings together the customers with satisfactory financial performances, but with a visible tendency towards worsening.
- Doubtful - D category – it includes the customers with low financial performances and caught in a visibly cyclic process with short periods of time.
- At loss - E category – for the customers with financial performances indicating loss and for who the perspective is clearly negative in terms of payment capacity for either the interest rate or the instalments.

The debt service, respectively the capacity of the economic agent of paying off the credits when they are due and of paying the owed interest rates on their due dates; it is appreciated as being:

- Good, if the instalments and the interest are paid on the due date with a delay that doesn't exceed 7 days.
- Poor, if the instalments and the interest are paid with a delay of up to 30 days.
- Inappropriate, if the instalments and the interest are paid with a delay of over 30 days.

Following the coordination of the data on his financial performance, the customer was classified as per the following matrix table:

The matrix of the financial performance of the customers

Table no. 1

<i>Financial performances/ debt service</i>	<i>Good</i>	<i>Poor</i>	<i>Inappropriate</i>
A	standard	under observation	sub-standard
B	under observation	sub-standard	doubtful
C	sub-standard	doubtful	at loss
D	doubtful	at loss	at loss
E	at loss	at loss	at loss

For each of the customer's indicator of financial performance, following his ranking between the established limits, each bank may give a different score.

By summing up the scores obtained by the customer for each indicator, a total score results, which serves as base for ranking the customer within one of the 5 categories mentioned before.

The quality of the warranties is appreciated based on the extent to which these warranties can cover the credit, as well as on their nature and legal character. Thus, depending on the nature of the warranties, each bank takes into account their own percentages in appreciating the value of the warranties, according to their own crediting rules. This has resulted in a distortion of the value of the goods used as warranty, as each bank, depending on its own crediting policy, would under-valuate or over-valuate the value of the spinoffs.

As of November 200, the Rule no 2/2000 of the National Bank of Romania (BNR) and the Methodological Norms for the application of the BNR Ruling no 2/2000, have introduced the following notions:

a) Debt service, which we discussed above and defined as representing the debt on its due date. Its size is expressed in number of days of delay starting from the due date.

b) Legal – initiating procedures that signify at least one of the following measures taken in order to recover the outstanding debts:

- Towards the debtor:

→ acceptance from the court of the request submitted by the bank, a third party, or the debtor itself for starting the procedures for judicial reorganization or initiating the bankruptcy procedure;

→ initiating the procedure for forced execution of the patrimony, in the case of a physical person;

- Towards the contract:

→investing the final court decision with an executor formula that covers the credit contract, as well as the warranty contracts, if that is the case, or the investment contract.

Credits and investments (deposits with other banks) are also classified into the following categories: standard; under observation; sub-standard; doubtful; at loss.

This classification is achieved by simultaneously using the following two criteria:

→ The debt service.

→ The initiation of legal procedures.

Given the relevance of these two criteria for appreciating the financial performance capacity of the customers, both the two criteria and the customer classification in itself have extended completely, which means that they also apply to the bank system, and not only to the non-banking one.

In the case of credits granted to the non-banking sector, the following matrix is applied:

The matrix of the financial performance of the customers in the non-banking sector

Table no. 2

Debt service / initiating legal procedures	Legal procedures have been initiated	Legal procedures have not been initiated
no more than 7 days	at loss	standard
8 – 15 days	at loss	under observation
16 – 45 days	at loss	sub-standard
46 – 90 days	at loss	doubtful
at least 91 days	at loss	at loss

For the banking sector, in the case of credits granted by one bank to another or deposits form with another bank, the classification matrix is as follows:

The matrix of the financial performance of the customers in the banking sector

Table no. 3

Debt service / initiating legal procedures	Legal procedures have been initiated	Legal procedures have not been initiated
no more than 3 days	at loss	standard
4- 15 days	at loss	sub-standard
16- 30 days	at loss	doubtful -
at least 31 days	at loss	at loss

The BNR norms no.8/1999 on limiting the credit risk no longer refer specifically to the analysis over the financial performance of the economic agents, which may in time lead to an adverse selection of the customers, and it is somehow illogical, contradictory to the principle of bank cautiousness that the banking law refers to. At this time, we believe that it is necessary for each bank to organize their own rating systems for granting credits, which has been achieved by the Romanian Trading Bank by setting forth such a system adapted to the service of this bank, as well as to the volume and structure of the credits it granted.

Under the pressure of trading banks and in order to repair the illogical situation in which customers were no longer classified in terms of their economic and financial performance, in 2002 the National Bank of Romania issued a new Rule no. 5/2002 on the classification or credits and investments, as well as on the establishment, regulation and use of specific risk provisions, and the Methodological Norms no. 12/2002 for its application.

The most important provisions of the new Rule are as follows: introducing the financial performance of the companies on the list of criteria to be taken into account by banks when calculating the provision requirements (thus the Central Bank indirectly recognized the error included in Rule no. 2/2000, allowing for an application of the principle of bank cautiousness), accepting the deduction (subtraction) from the bank's exposal towards the debtor of the warranties accepted to be taken into account (as per the Methodological Norms no.12/2002 of the BNR), only if there were delays in the payment of the debts related to the credit (instalments, interests, commissions) of more than 90 days, and no legal procedures were initiated.

Another concession on the part of the National Bank of Romania, that aimed to develop the real estate credit and the consumption credit, was the automatic ranking of the physical persons, in terms of their financial performance, in the A category, so that the banks may grant credits to the physical persons (who have statistically been proven to be the best payers) and create new opportunities for diversifying bank investments. Thus, the list of classification criteria for non-banking customers was complete with the criterion of “*financial performance*”, which expresses the economic potential and the financial solidity of an economic entity, as resulted from the analysis of a set of quantitative factors (economic and financial indicators calculated based on the data in the regular accounting statements) and qualitative factors; also, there was a re-formulation of the criterion named “*initiation of legal procedures*”, which is considered to be at least one of the following measures taken in order to recover the outstanding debts:

1. Submitting to the court the decision of initiating bankruptcy procedures.
2. Initiating forced execution towards physical persons or legal entities.

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