THE CREDIT RISK- COMPONENT OF THE BANKING RISKS

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Abstract: The risk management means the risk identification, evaluation, quantification and the strategy to counter and to find solutions and levers which can abate or even eliminate the possibility to appear of the probable consequences if they have place. The credit generates risks. The inadequate financial state of the companies plus the economic conjuncture and the absence of the surveillance are the principal causes of the risks. From the bank perspective, the effects are materialized in total or partial looses of the borrowed capital.
As consequence, to avoid these risks or to diminish it, the banks proceed to the carefully analyze of the authorized limits to offer credits, to create immobile and mobile guaranties, the carefully surveillance of the clients activity during all the time of the credit.

JEL Classification: G32- Financing Policy; Financial Risk and Risk Management;

Key words: Credit, risk, risk management, risk assumption, financial risk, corporation risk, bad credits.

1.Introduction

The banking risks management, as a basic element of the banking management, follows to diminish as possible the negative influences of the risk elements, to minimize the loss by reducing the expenditures and to maximize the direct and transferred incomes, to modify the employers' behavior and to improve the bank image.
As a component in the banking risks, the credit risk is the risk assumed by the bank in case of failure of one of its clients. A bank which is strong employed in a company, by the participants to its capital and by the credit offered, will confront with this risk in the case of failure. The cause of the credit risk is the bad financial state of the companies and the term economical aspects.
Depending of the guaranties natures and the capitalization possibility, the risks that a bank exposes are: partial and total risks.
The protection of a bank against the risk means to create immobile and mobile guaranties, the carefully surveillance of the authorized limits in offering credits; the surveillance of the clients activity during the credits, in the situations of payment delay the bank must action to find the causes which have generated the delay, the payment possibilities and the recovery of the remaining rates.

2.The literature and the practice in the domain

The French Rauch and Gerard Nauller, in their book "Le control de gestion bancaire et financiere" define the risk as a commitment having an incertitude, having a win or prejudice probability, as abasement or loss.
The International regulations Bank of Basel presents one of the most complex classifications of the banking risks and their issues.
The practice in the domain of a bank against the risk means to create and to respect the procedures against the risks. The procedures regarding the credit risk must regard all the activities and to see the credits at the individually level and at the level of whole portfolio. These procedures must be established by the commercial banks in the function to assure the identification possibility since the analysis level of the bad credits, presenting evident signals

regarding the impossibility to repay in the future the terms establishes for the rates and the interests, the evaluation of new business opportunities, the credits according, the maintain of solid standards of credit, the monitoring and the control of the risk control, the BANKING RISK.

3.The banking risk. Concept and classification.

Etymological, the concept comes from the Latin "re-secare", which means a fissure in a balance.
In the banking activity, the risk assumption can be investigated for its probable future advantages, as for example the speculative operations on the finance market, but also of the probable loss.
In generally, the risk assumption is related to the basic function of the economy, the investment function. Because the risk is an attribute of the investments in generally, the risk assumption becomes inevitably and justifies the banks existence.
The banking risk can be considered a phenomenon which appear during the ongoing of the banking operations and creates negative effects over the activities, by damaging the business qualities, diminish the profit and even record loss, affecting the bank function. The banking risk can be created into it, by its clients, because of the extern competitive average.
To treat the complex subject of the risks in the banking activity, it is necessary first a clear and coherent definition of it.
The banking risk can be defined as:
-a complex of events with adverse consequences for the bank;
-an uncertain event possible and future which can affect the whole activity of a banking company;
- the probability to not get the profit expected or even to have a loss during a transaction.
The credit activity of the banks confronts with the following types of risks:
1.Finance risks
2.Intermediation risks
3.Banking risks.
1.<u>The finance risks</u> are assumed in the process of adjustment of the patrimonial structures according the accountant balance.
In this case we can find:
-The solvency risk comes as a consequence of the non-fulfillment of the credit contract clauses by the client. The failure of the conditions can be lead to a definitive loss of capital for the bank or, in the best case, it can be recovered partially or delayed, of a part of the credit.
"It must be also noted that an uncontrolled growth of the interest rate can bring to the multiplication of the insolvency cases of bank debtors, because the growth of their liabilities generates, usually, beneficiary liabilities of credits unpaid on time. From the banking practice, it results that the must important aspect is the accent which must be put on the risk evaluation when offering credits and on the definition of the current risk interval." [1]
-The liquidity risk indicates the potentially incapacity of the bank to finance and to honor the own obligations on short time. "This type of credit corresponds to the treasury risk, which doesn't always put the problem to realize the demanded liquidity, but the price which must be paid to get it. From this reason, the banks, using specifically processes, must permanently study and maintain an adequate level of liquidity" [2]
As the bad credits level increase, the bank gets a reduction of the clients capacity to sustain the due service.
The prognosis of the financial needs diminish the exposure to the bank.
The risk of the interest rate or the market risk means the probable negative effect of changing the interest rate, which actions over the cash flow, but also over the value of the actives and passives banking. It is possible to get often an emergent banking market. As a consequence of the increase rates development, the banks profits are diminished because of the high cost of the financial

resources purchasing. If the costs of the resources purchasing increase faster that the gain from clients:
-it can result the registration of negative gains, the fall of the net value and even the possibility to appear the insolvency bank danger."
2.The intermediation risk of the banks in their quality of suppliers of banking services are:
-The efficient operating risk, which means the capacity of the bank to provide the maximum of services in a profitable manner.
-The technological risk express the possibility that certain banking companies become inefficient because of the distribution system of the banking services. The incorrect choice of the moment to put on the market a new product or the moment to introduce the new one can create significant loss and there is the risk that the moment be not the best from their point of view of the banking profit maximization.
-The risk of the new product is associated with the introduction and the diversification of the products offer at new banking services. It shows the cumulated probability to produce many adverse effects, as: the demand location under the anticipated level of the overcome of the planned level of the specific costs, the lack of professionalism of the managing team etc.
-The strategy risk represents the bank capacity to select the geographical and operating areas which will be profitable on the future for the bank. It express the probability to not choose the best strategy in the given conditions.
-The fraud risk regards the theft and the distortion of funds by the banking functionary.
-The operational risk express the possibility to make mistakes in the correct ongoing of the banking operations, material implications and implications which affect the society prestige and it's position on the market. It express the probability that the bank become unable to assure the serving of the clients in a profitable way. In this context, the important things are the services offered and also the capacity of the direction to evaluate and to control the expenditures generated by the services provide.
3.The banking risks that the bank must assume in its quality of banking enterprise, having the activity regulated by the Central Bank.
Here we have:
-The economical risk is bound of national and regional economical factors, which can significantly and negatively affect the banks activity.
-The competitiveness risk appears because the majority of the bank services and products can be offered, especially in the developed economies, by a big number and variety of banking societies.
-The regulatory risk or the legislation risk means to apply regulations that can put the bank in an advantageous position on the competitive plan and to accept the fact that the legislator can modify the regulations in a measure unfavorable to the bank.
-The system risk is the danger that a bank failure entrain a chain if similar collapse in the whole financial system.

3.The risk classification- general aspect regarding the foresights of the Basel II Agreement in the domain of the credit risk

One of the most complex classifications was elaborated by the International Bank of Regulations from Basel. Conform to this classification, the banking risks are:
A.Financial risks:

-the risk of the interest rate
-the risk on the rate of exchange
-the risk of liquidity
-the risk of the titles with variable income

B.Risk related to partners:
- -the customer risk
- -the risk appeared on the interchange marget
- -the country risk
- -the credit risk

C.The commercial risk
- -the products risk
- -the services risk
- -the market risk
- -the image risk

D.Risk related to the workforce

E.Operational and technical risks:
- -the operations quality
- -the level of computerization and telecommunication

F.The risk of the intern management
- -the regulation risk
- -the ethics risk
- -the strategy risk
- -the risk of functional failure
- -the risk of human resources
- -the communication risk
- -the total financial internal control risk

The committee of banking surveillance from Basel:

-is an international organism created by the ambassadors of the banking surveillance authorities and of the central banks from the principally industrialized countries.

-acts in periodical meetings (at every 3 months) at the headquarters on the International Bank of Regulations from Basel (Switzerland): Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, Holland, Sweden, England and USA.

-the agreement from 1988 has established a minimum limit of the capital because of the credit risk- the most important risk for the banks- even if it was presupposed that the whole capital offered (minimum level 8%) covers also other types of risks, by including it in the credit risk.

-from 1996, the market risk was separate and, for its cover, it was allocated a level of the capital. The majority of the first class banks offer in present more than 20% from their capital to the operative risks.

-in 2001, the Committee of Basel has elaborated the project of a new agreement regarding the minimum capital of the banking enterprises, necessary to cover minimum 8% of the bank exposure to the principal risks- risks of credit, of market and operational risk, and it was revised after the consultation of the ambassadors of the banking sector and of the surveillance authorities from all the world, the last form being issued in April 2003.

4.THE CONCEPT OF CREDIT AND CREDIT RISK

4.1.The credit concept

According to the explanatory dictionary of Romanian language, the credit is defined as “an economical monetary relation who is created between a physical or a juridical person (creditor), which grant a loan of money or send goods and services on debt, and an another physical or juridical person (debtor), which receives the loan or buy on debt” [3]. Simple said, the credit is “a good or a service given to a person, with the obligation to return, replace or pay it after a time, usually with an addition named interest.

The credit content can be seen from more pointes of view. We can remember two ideas, to points of view, “the credit as a social relation and the credit as an object of a social relation”. In the first case, it defines a change relation or a repartition relation. As a change relation, we can define the credit as “a veritable change of present goods in exchange of future goods”. Other authors define it as “an economical category which shows relations of repartition of a part from the national gross product or from the national income, by who the availabilities existing in economy are redistributed, and the control over these sides is assured, in order to satisfy some objective needs of capital and to realize some economical political objectives”.
Regarding the monetary circulation and the money in 1821, Davis Ricardo affirms that: “the assignments of loan made for the issuant bank depend of the comparison between the profit rate that can be obtained bay using the sum and the rate that the bank can offer. When the market rate of the interest is more than 5%, that the England Bank use to offer, the discount service is assaulted from the loan demands; when the market rate is even temporary less than 5%, the functionaries from this service have nothing to work”.
Regarding the public credit system, system of the state dues, which started in the Middle Ages in Geneva and in Venice, “it take over the whole Europe, during the manufacturing period. It result the idea that a nation becomes rich if he has more dues. The public credit becomes the capitalism creed.
The credit was and still is considered “the life nerve of the production”. Starting from the theory of the tree factors of J.B.Say, a Romanian economist said that “the production is created from tree producer factors: the land, the work and the credit. But the must important element is the credit, because it can buy the land and the work, and the production is only a credit problem, where the credit is organized and simple it produce the surplus and the prosperity, where it is expensive, it eats all the income, where it produces stagnation and consume from the whole, as it happened to us, there it produces equalize”.
The credit is a relation with a special character, which appears between the sender and the buyer, when they transfer money in exchange of a prices named interest. From the point of view of the theory, but also of the practice, the credit needs a double approach. In the juridical assumption, for example, the credit is considered a convention between a creditor and a debt, usually materialized in a contract, regarding the production, the delivery and the payment of the value of some utilities. In the economical theory, the credit means the relations into the economical mechanism of a country, that mobilize the resources of temporary capital available, after well defined rules, to satisfy the financing need of the entrepreneurs.
Specifically to the credit relations is that they define a value transfer repayable, for a limited time horizon and with the obligation to pay the interest, as a price of the capital borrowed.

4.2.The concept of credit risk

The credit risk is defined as the probability that the debtor or the issuer of the financial instrument can not pay the interest or to repay the capital according to the conditions from the credit contract- it is an inherent problem of the banking activity. The credit risk means that the payments can be delayed or even not made, and this will implicit cause problems on the cash-flows and will affect the liquidity of the bank. The credit risk rests the uncial principally cause of the banks failure. The reason is that more than 80% from the bank balance refers in generally to this aspect of the risk management. The principally 3 classes of credit risk are:

-the consumers risk
-the company risk
-the country risk

4.3.The management of the credit risk

The management of the credit risk principally concentrates on the credits portfolio.

The appearance of the banking risks is determined by a complex of factors, that depend of the generally evolution of the economy, changes related to the bank organization, the financial decisions, the political and economical conditions.

The economy evolution can be seen the dynamic of PIB, the inflation evolution and the monetary stability.

The banks depend of the economical state of a country at a given moment, because in upstream the decisions of monetary politic taken by the central bank are applied by the banks, and in downstream the banks get their resources and make placements from and over the non-banking average, which generates macro-economical results and, in the same time, affected by the general evolution of the economy.

The activity of surveillance of the credits offered has as end the knowledge and the action to limit/ diminish the risks that the bank supports as a consequence of the activity of credit, including the fulfillment of the contractual obligations that result from the assurance contract of the financial risk, in the case of the credits offered.

The objectives of the surveillance activity are:

-the prevention of the non-payment risk for the credits offered to physical persons by watching the delay data

-the avoidance of the residuals accidentally registered because of the absence of time, on the ignorance of the delay data or the inadmissibility of the account balance, in case of DAC (discovered account authorized);

-the identification of clients with degradation perspectives of the economical-financial state, in order to take good measures;

-the recovery of the clients residuals;

-the rehabilitation of the problematical credits.

During all the period of credit, the bank will watch in permanence the way in which the client uses the credit, if he uses for the end that he declared and if he respects all the contractually conditions.

The payments or the credits offered are made only after signing the credit contract, the drawing of all the legal documents regarding the creation of assurance guarantees accepted by the bank and the assurance polices presentation, issues from the enterprises of assurance-reassurance agreed by the bank.

The credit moderator is responsible to verify the use of the credit for the end approved and he has the obligation to approve all the payment documents presented by the client.

The payments from the credit account will be made on the measure of recessions, with the sums demanded by the clients and accepted by the credit moderator, including the commissions afferent to these payments. The payment documents rest to the bank to make the payment, they a copied and put into the file of client.

The credit moderator will watch the process of the economical agent activity, the capital movement by the bank, the way of paying on time the rates and the interests. If a discrepancy comes, he will make an analyze of the causes and he will identify with the client the solutions.

If by approving the credit it is mentioned a term of employment of the credit, but until that data the client don't use or uses only a part of the credit, the moderator has two possibilities:

-he asks to the organisms which approved the credit to carry-over the employ term, mentioned in an additional act;

-he makes an additional act to diminish the credit at the level of the credit already used, by an express acceptance from the Committee of credit and risk.

In this send situation, it is made a new amortization graphic,here every rate will be smaller that the rate from the month of that graphic.
If it is seen that the credit beneficiary used the credit for other destinations that the those that they established in the credit contract, the credit moderator has the professional obligation to inform immediately the direction of the bank, who will take the following measures:
-the ceasing of the using of the accorded and unused credit and of the acceptance of other credits;
-the pass of the credit to the remaining and measures to recuperate the credit and its costs;
-the sanction against the bank employs guilty of the non-respect of the credit destination, by respecting the Working Code.
The attentive and responsible surveillance of the credits use presuppose also periodical visits of the credit moderator at the economical agent, where he will pass to the economical-finance analyze using the last balance of check, the effective control of the guaranties from the point of existence, integrity and conservation, the investigation of their causes and the consequences that the probable modifications in the activity or in the management of the enterprise can have over the relation of the client with the bank.
The surveillance of the credit has place during all the ongoing, to prevent the default.

5.The research methodology

The credit risk, as a component of the banking risk, is a problem often considered at the last time, so the theme chosen is very actual and in concordance with the most recently studies and steps made in the banking system regarding the new management demands of the risk and of approach conform to Basell 2.
We proposed to make an analyze regarding the banking performance of the credit risk management and measures regarding the diminish of the elimination of it, starting from the risk management, which means the identification, the evaluation, the quantification and the strategy to counteract, to find solutions, to find ways to simplify or to eliminate the possibility of appearance and the consequences in case of appearance.

6.Conclusions

To eliminate totally or partially the credit risks and to get the financial performance, the banks should consider the following aspects:

-an adequate banking prudence, to manage a credit portfolio of quality, with a good capacity and an assumed risk;
-the knowledge of the client, knowledge that must consider:
  -the client character
  -the client competence
  -the client capital
  -the quality of the relations with the business average
  -the quality of the credit guarantee
  -the knowledge and the better selection of the clients and their business
  -the identification and the evaluation of the payment capacity of the clients
  -the adequately guarantee and the consolidation of the credits offered
  -the reimbursement on time of the credits, the surveillance and the recuperation of the difficult debt
  -periodical visits to the client
  -economical-financial analyzes over the client activity
-the creation of a general reserve for credit risks and for risk provisions;
-the credits must be guaranteed in all the cases, they must strictly respect the intern norms of credit;

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