RISKS' INFLUENCE ON THE ROMANIAN BANKS' FINANCIAL PERFORMANCE

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***Abstract**: The banking sector is highly volatile due to the influence of a large objective and subjective factors and the banking institutions must defend onself against all the risks. Therefore, risk awareness should be intuitive, while the decisions on risks by the banking management must be proactive, not passive and careless. The role of credit in the economy is represented by economic results achieved by the expression of the credit relationships and the contribution that it has in achieving the objectives of economic country policy.*

This paper aims the benefits of the risk management implemention into the lending activity of banks in Romania to increase the efficiency by the lending activity of the Romanian banking to improve the banks' performance of our country.

***Key Words:** risk management, lending banking risks, banking performance.*

1. Introduction

The risk management process involves the risk assessment, control, transfer and minimizing/limiting losses in order to plan a positive response to the action of risk factors. The risk can be defined as "a systematic way of managing potentially hazardous events and insecurities induced and introduced by the modernization process" and in more advanced statistical theories of risk assessment it is presented a more elaborate definition according to which "the risk reflects variations of possible results distribution, probability and subjective values" [1]. In the left part of Fig. 1, it outlined a "disconfort area" where one can find the " Risk alarmist" and the "Risk obverse", and the right part of the same figure design the " Risk seeker" and "Risk dependent", which form a "confort area" and also the all four attitudes towards risk represent the reactions to uncertainty.

The credit policy is administered by the central bank with tools and techniques, which aims to ensure, by promoting credit functions, general general economic equilibrium as fallows [2]:

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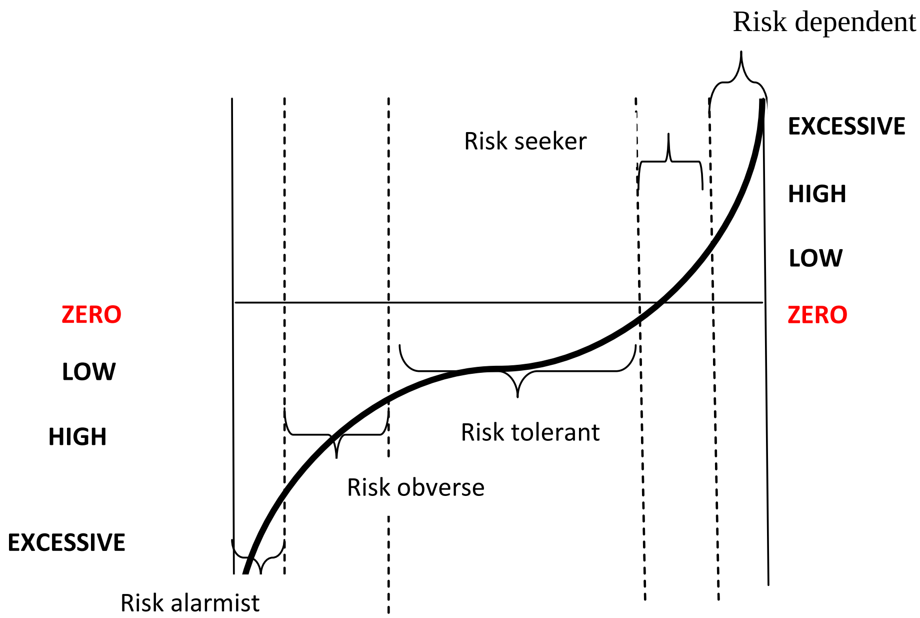

Fig. 1. Attitude towards risk spectrum.[3]

- **open market operations, the secondary market**:
  - reverse operations;
  - direct purchases/sales, the acceptance to extend collateralised loans, claims or securities of the State, central government and local autonomous administrations, national corporations, national companies and other majority state-owned companies, credit institutions or other legal persons;
  - currency swaps ;
  - issuance of deposits certificates and collection of deposits from credit institutions, under which it deems necessary to achieve monetary policy objectives.
- **lending operations**: within enter their lending, in terms of repayment, interest level according the Romanian Government Emergency Ordinance no. 99/2006 by the credit institutions;
- **controlling liquidity:** through minimum reserve system by the banks are required to establish and maintain them into the accounts within the central bank. NBR establish their regime and charge interests at least the average interest rate for deposits with credit institutions. The reserve requirements are designed to ensure minimum liquidity ratios of banks that are established with their depositors. As a monetary policy tool, they act on limiting banks' ability to multiply customer deposits in the money creation mechanism. During the last years current year there is an increase in

lending to the real sector, amid negative output gap and strengthen the positive parameters that characterize the domestic macroeconomic environment.

NBR continued to support the sustainable resumption of crediting the real sector through specific instruments of monetary policy: monetary policy rate was reduced by 175 basis points during the mentioned period (from 3.5% in June 2014 to 1.75% in June 2015), as a signal to commercial banks in order to reduce the cost of lending in national currency in tandem with the improvement in the domestic macroeconomic environment; reserve ratio applicable to the liabilities in lei of credit institutions was reduced gradually from 12% to 8% and the applicable foreign currency liabilities was reduced from 18% to 14% to increase the amount of resources available for lending to the real economy [4].

2. Romanian banking credit portfolio overview during last years

In Romania, during 2012-2015 years, the bank assets fell from 402 billion lei (2012) to 400 billion RON (2015) while credit to the private sector fell from 230 billion RON (2012) to 210 billion RON in 2015 [fig.2].

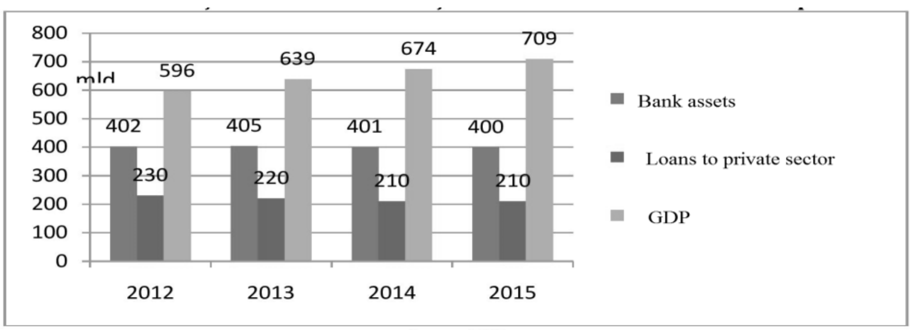

Fig. 2. Author’s calculation based on the data assets of BNR Financial Stability Report, April 2016.

According to the NBR’s Bank Lending Survey (2015) since the release of the previous Report, the main changes are: (i) the recovery of non-financial corporations’ credit demand starting with 2015 H2, on the background of credit standards remaining broadly stable; (ii) banks’ expectations of tighter credit standards on loans for house purchase following concerns fuelled by the unpredictable legislative framework regarding household loans.

The credit risk associated with bank loans to households remained on a downward path, amid the further implementation by banks of non-performing exposure resolution measures. The step-up in lending to households in the context of historically low interest rates calls for special attention from a financial stability standpoint. By Romanian banking sector, the financial situation of firms in construction and real-estate sectors remains considerably below the economy-wide average. This is somehow a counter-intuitive evolution, given the highly pro-cyclical nature of the mentioned sectors which should have already benefitted by the substantial economic growth seen over the last years.

Among the top companies with a sound financial standing are: (i) foreign trade firms; (ii) direct investment companies and (iii) technology-intensive companies. The corporate loan portfolio quality[2] continued to strengthen, but there is still a large room for improvement because the non-performing loan ratio went down to 26.2 % in December 2015, from 28.1% in June 2015. The insolvent firms' exposures, the non-performing loan ratio in the banking sector would have been of around 15% in December 2015, also promote the negative effects on external creditors, given that they have outstanding loans from foreign financial institutions in amount of EUR 1.3 billion and loans from parent undertakings worth EUR 1 billion (in September 2015). The part played by insolvent companies in generating major payment incidents in the economy diminished significantly in the second part of 2015: in December 2015, firms undergoing insolvency proceedings accounted to 17% of the volume of major payment incidents [4].

2.1. Credit risks management contribution

Credit risk makes the largest contribution to capital requirements, i.e. 83%, implying the high significance of bank asset quality monitoring. To overcome systemic deficiencies and procedural kind, which leads to increased losses in the loan portfolio, banks must design and implement credit policy performance and employ/prepare a staff of professionalism perfectly, to understand and respect discipline those rules. By this reason it's necessary to have a permanent feedback for top banking management about the effectiveness of credit quality control process. The risk management implementation within the banking activity requires [6]:

- analysis and approval the launch of those banking products or activities which generate risk by the bank management;

[2] According to Financial Stability Report April 2016, the credit migration matrix indicates that most debtors (over 70%) remained in the first risk bucket during April-December 2015. In addition, only 9% of the exposures unlikely to be paid with a debt service past due less than 15 days were undergoing bankruptcy, insolvency or reorganisation proceeding. For approx. 45 % of the exposures unlikely to be paid, banks took restructuring or refinancing measures consisting of changes in the terms and conditions on loans to debtors failing or likely to fail to meet their credit obligations.

- using clearly defined criteria for credit granting, by type of client, involving both detailed knowledge of the borrower and also the credit destination or source of repayment, the application of real or personal guarantees to mitigate credit risk to acceptable levels ;
- a good formalized processes for credit approval, including a clear system of approval powers;
- continuous monitoring of exposures at individual or group level exposures where appropriate and regular monitoring and reporting, the bank management, the quality of credit portfolios; identify and manage non-performing loans and various aspects resulting from this activity.

The weak credit quality is the main cause of bank failures following possible defining test cases:

- carelessness in formulating lending standards;
- the existence of too generous credit conditions and the lack of clear regulations;
- non-compliance with internal lending by bank staff;
- credit risk concentration on certain parts / banking products;
- the weak control exercised over staff (inspectors);
- excessive increase in the loan portfolio over the possibilities of the bank to cover reasonable risks;
- damaged or inexistent systems for detecting problematic credits;

lack of customer cash flows; preferential loans (under market conditions).

3. Some closing remarks

Continuous improvement of quality and efficient realization of the effects of monetary policy actions through analysis, implementation and communication processes inflation targeting. Overnight interest rate stability and liquidity support for the banking system must be guaranteed by the capital markets.

Banking operations of the central bank must focus on effective and ensuring monetary and financial stability. The monitoring risk and preparing a plan for unforeseeable situations is a strategy which lays emphasis on choosing a set of indicators and following their evolution during the entire execution of the project. Plans for unforeseeable situations appeared as an alternative to risk, by preparing certain response strategies before their manifestation and are set on situations of financial risk and technological risk. The strategy which follows the transfer and distribution of risks can be implemented in the case in which very expensive technologies are used and very high risks are involved. The solution is the transfer of risks to another specialized institution which has superior competencies in monitoring and control of risks. Systematically reduction of risks is a strategically option which implements a complex of methods and strategies in order to systematically diminish risks within the limits of an acceptable threshold [5].

The NBR is closely monitoring risks to financial stability generated by developments on the real estate market. On 16 March 2016, the Parliament of Romania adopted the Law on the macro prudential oversight of the financial system, providing for the establishment of the National Committee for Macro prudential Oversight (NCMO) to support the risk analyses made by financial institutions, it's envisaged to enhance the transparency of information released by the NBR, at least of that related to lending and non-performing loans. Therefore, macroeconomic and financial developments will be closely assessed in order to identify risks and vulnerabilities, and other instruments will also be implemented, where necessary, with a view to properly managing the financial risks identified across the system [4].

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