THE CONTROL AND ADMINISTRATION OF THE RISKS
AT THE LEVEL OF THE BANKING COMPANIES

LOREDANA CIURLĂU *

ABSTRACT: The banking companies assure their incomes, their profits from specific activities, namely from cashing and payment activities, loans, bank placements, financial consultancy, on assuming certain risks. Any banking activity supposes a risk which accompanies all the businesses and it is or it is not produced given the conditions. The risk management and control must be understood on a larger scale, as an action, and on a smaller scale, in an individualised manner on persons responsible with the risk supervision.

KEY WORDS: banking risk, banking regulations, banking risk categories, measurement and control indicators, techniques of administration of the banking risk

1. IDENTIFYING AND CLASSIFYING RISKS IN THE BANKS

The administration of the risks in bank is, first of all, the responsibility of its superior management and of the executive management, which must fulfil the directives of the top management. The main objectives of a good management and control system of the risks aim:

- The establishment of a mutually accepted definition of the risk, which is to determine the elaboration of a “map” of the risks of the bank;
- The overfilling and continuous elaboration of the existing and potential sources of internal and external risks;
- The establishment of a clear responsibility in the field of the risks management (up down) and of the reporting system (down up) in order to avoid confusions, the superposition of the efforts and the leaving out of some important aspects;
- The assurance of some transparencies, of an overfilling system of informing the management and of a monitoring and reporting system, which should present, analyse and communicate the effective exposures, winnings and losses which must be known and stocked for future references;

* Lecturer, Ph.D. Student, “Constantin Brâncuși” University of Tg.-Jiu, Romania, lcurlau@yahoo.com
- The elaboration of a system of measurement of the financial performances, which should take into consideration the foreseen loss (the cost of the activity cost), the unforeseen loss (the measurement of the risks), the capital allocation on each risk, where it is possible, and the incomes adjusted for each risk (the profitability of the capital adjusted with the risks);
- The evaluation in accordance to the market of the cost of the capital, of the minimum rate of the profitability and of the possibility and the limits of the organic increase of the exposures to risk;
- The definition and the use of the principles of diversification of the risks and of management of the portfolio.

The measuring and the interpretation of the risks which must be assumed in order to obtain the desired earnings (results) are very important for a banking entity. The bank takes the responsibility for all the specific risks, occurred as a consequence of the getting of profit, in a safe and calculated manner, considering the following factors: respecting the prudential measures imposed by the regulatory national authority; the forecasted must justify the risk exposure; the risk must be dimensioned, so that the loss produced by materialisation could be acceptable for the activity of the bank, and the image of the bank does not suffer; the possible losses should not strongly influence the financial situation of that particular year, being able to be covered from the already constituted provisions or from the profit;

In the specialty literature, and also in the practice of the banking activity and of the banking financial credit it is considered that there are the following banking risk categories at the level of the banking entities:

- **The credit risk**, which quantifies the probability of the non reimbursement on due term of the granted credits and afferent debts;
- **The liquidity risk**, which indicates the potentiality of the bank to support at a certain moment the cash necessary;
- **The interest risk** refers to the potentially negative effect on the cash fluxes, the value of the assets and the value of the debentures due to changing of interest rate;
- **The capital risk** or the solvability risk is assimilated to one of the functions of the banking capital, that of protecting the depositaries and the borrowers against a depreciation in the value of the assets.

To all these four categories is added the foreign currency risk, being regarded as a derived risk, but which has a great importance thanks to the liberalization of the monetary fluxes. The banking risks can be classified on more criteria:

1) in accordance to the **risk exposure**, we distinguish:

a. **the pure risks** are characterised through the fact that the risk exposure is generated by the banking activities and processes which have the potential to produce losses, in which are included:

- the physical risks, which can manifest the destruction of the building in course of construction, the phone lines etc.;
- the financial risks can appear as complete data losses, losses of checks in course of cashing, losses of effects, non retrieval of losses and so on;
- the criminal and fraudulent risks – entering in data-processing files, fraudulent use of the payment media;
- responsibility risks: the violation of the norms regarding the opening of accounts, effects losses in the account of the clients, administration errors of the accounts and of the services of fructification of the savings.

**b. lucrative or speculative risks**, the exposure is generated by the attempt to obtain a greater profit; this exposure can also generate supplemental expenses and thus, potential losses.

2) in accordance to the **banking operation range** which can generate risks and form these risks. These risk forms are shown in table no. 1.

**Table 1. Types of risk**

<table>
<thead>
<tr>
<th>Banking characteristic</th>
<th>Risk group</th>
<th>Type of risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance-sheet operations</td>
<td>financial</td>
<td>Crediting risk, Liquidity risk, Market risk and bankruptcy risk</td>
</tr>
<tr>
<td>Banking services</td>
<td>of providing</td>
<td>Operational risk, Technological risk, New products risk, Strategic risk</td>
</tr>
<tr>
<td>Activity frame</td>
<td>environmental</td>
<td>Fraud risk, Economic risk, Competitive risk, Legal risk</td>
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</tbody>
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The risks identification, and also their localisation represent the first global administration stage of risks, within it we must determine the risks associated to every type of banking product and service. Once the associated risks are identified, it is necessary the elaboration of some possible scenarios to determine the frequency and the amplitude of each type of associated risk. After the identification of the risks on every type of banking product and service, the sketching of a liked image of the risk factors influence is necessary.

The methodologies of identification of the risks, and also of their evaluation can assure an effective, efficient estimation, of the risk profit for all the banking entities, and also on their whole.

After the identification of the risks and their localisation, the process continues with the objective analysis, which is never interrupted. In order to establish the departments responsible for the risk exposure from a bank and whose task is to make the analysis of the types of risk, and also of their treatment manner, are used: the annual administration report; diverse accounting reporting; the organization chart of the bank.

Important for the tracking down of the risks even before they become real are the permanent and open communication between the compartments of the bank, this fact offering the possibility of controlling the risk from the moment of its apparition and the moment of its discovery, through the analysis of the financial and accounting registrations. Another raised problem is that of the assumption of the risks by the
bankers, who are familiarised to the assumption of the risks in the daily activity, but they are reticent in the total or partial assumption of the accidental risks.

The identification of the risks also supposes a good training of those who work in the departments of the bank, both to know the conditions, events, states that can lead to the apparition of some risks specific to each sector, where the banking management acts, and also the methods and the techniques specific to the identification and monitoring of each risk type.

2. INDICATORS OF MEASURE AND CONTROL OF THE BANKING RISKS

Within the analysis of the banking risks, a special importance goes to their quantification, based on a system of specific indicators, which allow the statistic and dynamic re-evaluation of the risks, by reporting on international standards or the own historic experience of the bank. The measuring of the risks which relate directly to that of the incomes (because in order to obtain profit, a bank must assume risks).

Hence, the risk indicators get more relevance in a general context of the appreciation of the bank profitability and its competition on the market, the final objective of the banking manager consisting also in the maximisation of the incomes of the stock holders adjusted by the risks influence.

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

- the indicators of the crediting risk;
- the indicators of the liquidity risk;
- the indicators of the interest rate risk;
- the indicators of the foreign currency risk.

2.1. The indicators of the crediting risk

Almost all the banks, assume their crediting risk, which supposes the necessity of the careful analysis of the way in which the quality of the credits portfolio evolves, with a special impact on the profitability, the adequacy of the capital and the general trust in that particular bank. Thus, two reference indicators for the estimation of the crediting risk are determined based on the weak quality weight, which delays or do not allow the achievement of the anticipated incomes, namely:

\[
\frac{\text{the volume pf the residual credits}}{\text{total credits}} \times 100 \quad (1)
\]

\[
\frac{\text{the volume of the non performing credits}}{\text{total credits}} \times 100 \quad (2)
\]
Of course, the optimal is represented by the minimal values of the two indicators, tending towards zero, in the second case, the residual credits, but most of all the non performing ones engraving the financial activity and results of the bank.

Other indicators of the crediting risk use the formula of calculation of the reserves and provisions that the banks make for covering the possible losses, such as:

\[
\frac{\text{reserves for credit losses}}{\text{total credits}} \times 100 \quad (3)
\]

report which synthetically express the managerial expectations regarding the evolution of the quality of the loans portfolio;

\[
\frac{\text{provisions for credit losses}}{\text{net credits}} \times 100 \quad (4)
\]

report which reflects the prudence level adopted by the bank in its crediting policy.

\[
\frac{\text{the gross profit}}{\text{provisions for losses from credits}} \times 100 \quad (5)
\]

namely the cost of covering the crediting risk assumed by the bank.

The potential indicators of measuring the risk which can signal in advance, the variations of the incomes of the bank are: the geographic concentration and the concentration on economic sectors of the credits, the accelerated rhythms of increase of the credits volume, the high profitability of some credit categories. Although none of the indicators mentioned do not represent a perfect predicator, we can state that the inappropriate level of one of these constitutes a barometer of the future crediting problems.

2.2. The indicators of the liquidity risk

Thanks to the informational limits of the cash flux system, the banking analysts use a series of indicators for the measuring of the liquidity. The more cash or banking assets the bank has, the greater its capacity to cope with the deposits redrawing demands, and also the eventual delays in the reimbursement of credits. The commercial banks normally keep between 20 and 30% from the deposits as liquid funds.

The main indicators that the treasury calculates and verifies for the analysis of the liquidity are:

- the global liquidity, which reflects the possibility of the patrimonial elements of assets to turn themselves in short time into liquidities, in order to satisfy the contingent payment liabilities.
- the immediate (treasury) liquidity, which reflects the possibility of the patrimonial elements in assets to cope with the debts representing the total of the deposits and of the loans.

The treasury also determines the exposure of the bank in accordance to the deposits at sight (namely the report between them), which express the tendency of evolution of the deposits on term, comparative to that of the availabilities at sight with influence on the stability of the resources and the level of the costs.

Other indicators which are calculated for the estimation of the risks are:

- the position of the liquidity, indicator derived from the practice of the treasury administration, which is calculated on days, weeks and months and whose optimisation consists in the equilibration of the liquid assets with the immediate liabilities. In the case of a negative position, the liquid assets are insufficient for the integral honouring of the obligations, the bank having to appeal to urgent financing sources, such as: loans on the interbank market, loans from the central bank and the liquidation of some portfolio assets before the term. If the position of the liquidity is positive, the liquidity excess is placed on short term in deposits on the interbank market.

- net liabilities, namely the difference between the assets and the liabilities classified in accordance to the due term, an indicator which is calculated to signal a period of maximum liquidity need. The simple net (successive) liabilities are determined on each period, as a difference between the assets and the liabilities with the same due term. The net liabilities are determined as the difference between the cumulated liabilities and assets, corresponding to each period of time;

- the liquidity index, which represents the report between the amount of the liabilities and of the assets, both weighted with the average number of days or the current number of the group of that particular due term. If the liquidity index is:
  - = 1: then the bank must not make a due term transformation;
  - < 1: the bank makes the transformation from short term liabilities in long term liabilities, in the conditions of the ascending curb of the interest;
  - 1: the bank transformed the long term liabilities in short time liabilities, resulting the liquidity risk.

- the liquidity rate expresses the evolution of the indebtedness degree of the bank to the monetary market. This is periodically calculated, in accordance to the due term of the loan operations, according to the formula: new contracted loans/loans due in the same period * 100. A superunitary rate indicates the increase of the liquidity thanks to the increase of the indebtedness degree, the relation being inversed in the case of a subunitary rate;

- the total report credits/total deposits reflects the proportion form the resources drawn from deponents which is loaned to other clients. The greatest part of the credits is liquid.

The traditional measures of preventing the liquidity risk generally tend to focus on the liquidity of the balance sheet assets.
2.3. The indicators of the interest rate risk

- *The capital adequacy* has permanently constituted an essential preoccupation of the banking management and of the profile regulations, thanks to its signification regarding the solidity of the bank and the safety of the deposits. The adequacy of the capital also has an important competitive dimension, the well capitalised banks being more attractive for the attraction of resources whether from deposits or loans in advantageous conditions.

- *The interest rate risk*, which is determined as report between the productive assets and the interests bearing liabilities (the standard level being 1);

- *The absolute margin of the banking interest* expressed through the net incomes interests, reflect the capacity of the bank to cover the expenses with the interests discounted at deposits, deposit certificates etc. from the incomes obtained by cashing the interests at the granted credits. The interest margin must be established so that they assure the support of the banking task (the difference between other banking expenses and other banking incomes), and also the obtaining of a satisfying profit.

- *The gross percentage margin of the banking interests*, which result from the reporting of the absolute margin at the productive assets * 100. Correlated to the level of the active/passive interests practiced by the bank, but also to the volume made by credits/deposits. A standard level of this indicator is contained in the 3 – 10% interval.

- *The net percentage of the banking interest rate* is calculated as a report between the average level of the active interest rate at the average level of the passive interest rate * 100.

The management and control of the financial risks give a special attention to the interest rate risk, which relates to the foreign currency one on a short term, when the parity conditions exist. In practice, the banks use simulations in order to analyse their exposure to the interest rate risk, determining the impact of some modifications in the interest rate on different categories of due terms on the profitability and the market value.

2.4. The indicators of the foreign currency risk

The foreign currency risk is included by the specialists in the category in the market risks, being determined by the variations of the exchange rates, the deficits of the payments balances of payments, the penury of liquidities internationally. This risk is amplified for each participant to the performance of an external payments transaction. The measuring of this type of risk is achieved based upon the positions they take from the commercial banks, which establish their operation limit in accordance to their own standing. The bank whose debts exceed its payment obligations in a certain foreign currency takes a long position, if there is a high probability that the foreign currency enters an appreciation process. Contrary, the bank takes a short position. Due to the economical context in which they action, the Romanian banks prefer the long positions not matter the exchange rate.

The indicators of the foreign currency that the commercial banks calculate are:
The individual foreign currency position is determined on each administrator foreign currency;

The global foreign currency position, which represents the net balance of the debts in foreign currencies in report to the liabilities in foreign currencies, both converted in the reference currency for comparability: this indicator offers a general image on the foreign currency exposure of the bank.

The indicators used for the quantification of the different risk categories generally respond to some international necessities in the analysis and management process of the banking risks.

3. CONCLUSIONS

In conclusion, the banking risks are a source of foreseen expenses, their adequate administration can stabilize the incomes in time, having a shock bumper role. At the same time, the consolidation of the value of the banking actions can be achieved only through a real communication with the financial markets and the implementation of some adequate programs and administration of the banking risks. All the banks and the financial institutions must improve their comprehension and the practice of the administration of the banking risks in order to successfully administrate their range of products. If the process of administration of the banking risks and the global management system are effective, then the bank will be successful. The banks can successfully administrate the banking risks if they recognise the strategic role of the administration of the risks, if they use the analysis and administration paradigm for increasing the efficiency, if they adopt precise measures of adapting the performance to risk and if they will create mechanisms of reporting of the performance in accordance to the risk, in order to make sure the investors understand the impact of the administration on the value of the bank.

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