NON-PERFORMING LOANS DEVELOPMENT IN ROMANIA

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ABSTRACT: *Bad loans are essentially loans with arrears of 90 days or more, and the criterion of 90 days is the most common practice in different countries to determine indicators on the bad in lending. Credit risk is one of the most important financial risks facing the banking system is assumed by all credit institutions and may cause serious problems so that bank and the whole system if risk exposure is substantial. From this point of view, the most important function of bank management is to control the quality of the loan portfolio. This is because the poor quality of loans is the leading cause of bankruptcy. In accordance with the central bank, credit institutions are obliged to protect the bank's capital and the deposits of individuals and legal entities and to cover any loans that present uncertainties in recovery, to determine and utilize prudential value adjustments. The central bank aims NPL development using aggregated indicators on credit institutions. Conclusions are presented on developments and trends in non-performing loans in the portfolio of credit institutions in Romania.*

KEY WORDS: *performing loans, credit risk, financial performance, debt service, judicial, aggregated indicators on credit institutions, outstanding receivables, receivables impaired, NPL, leverage, classification category.*

JEL CLASSIFICATIONS: *G21.*

1. INTRODUCTION

In theory there are several definitions for area non-performing loans that have the same common denominator: the arrears of 90 days or more, and the criterion of 90 days is the most common practice in different countries to determine indicators related to performing the activity lending.

Dictionary of Banking Terms - Thomas Fitch has the following definition "when paying interest rate and a loan is outstanding for 90 days or more, the loan is considered nonperforming".

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IMF recommends that the loans (and other assets) are classified as non-performing (NPL) when payment rates, representing principal and interest overdue for three months or more. Also include non-performing loans and those loans with debt service less than 90 days, but that national legislation deems underperforming.

Debt service is the ability of the borrower to meet its debt maturity and expressed as number of days of delay in payment by the due date

European Banking Authority (EBA), from 2013 a definition of non-performing exposure to ensure compatibility between EU countries. Non Performing Exposure (NPE) is any remaining exposure more than 90 days or is unlikely to be paid by the debtor without collateral execution, regardless of the existence of overdue amounts or the number of days rest.

This definition applies to all debt instruments in the balance sheet and off-balance sheet exposure. Also, when a debtor balance sheet exposures outstanding records older than 90 days, which is 20% of gross value gross carrying amount of all balance sheet exposures, it will apply the downgrading by contamination or by considering the weakest classification of individual categories. In this situation all exposures and off balance sheet of the debtor shall be considered as non-performing [1].

Table 1.

	Bulgaria	**Czech**	**Poland**	**Slovakia**	**Croatia**	**Lithuania**	**Slovenia**
Apply the criterion of "90 days" in the definition of non-performing exposure?	YES	YES	YES	YES	Yes - except for the security exposure exceeds the exposure, although the debtor has delayed payment over 90 days	NO	NO
If not, what other criteria (and what type of exposure) apply?					For exposures covered by collateral eligible institution will take the horse amount of those guarantees. If legal proceedings to recover the debt, exposure will be considered acceptable performance.	For the sake of reference: 1) Delinquent exposure over 60 days; 2) all impaired loans.	Non-performing loans are also advances to borrowers belonging to the categories of financial performance D or E (where there is a high probability of occurrence of the loss of part of the assets or there are no expectation of repayment of amounts).

2. CREDIT RISK

Credit risk (called risk of insolvency of the debtor or default risk) the probability of actual receipt at maturity, anticipated cash flow, determined by lending operations. It is assumed by all credit institutions and can generate serious problems so that bank and the entire banking system, if the risk exposure is substantial.
From this point of view, the most important function of bank management is to control the quality of the loan portfolio. This is because the poor quality of loans is the leading cause of bankruptcy.

In accordance with Law no. 58/1998, as amended and supplemented, NBR Regulation No. 16 of 20 December 2012 on classification of loans and investments and determining and applying prudential value adjustments, credit institutions are obliged to protect the bank's capital and the deposits of individuals and legal entities and cover any loans that present uncertainties in recovery, to determine and utilize prudential value adjustments.

Prudential adjustments are determined based on the credit classification categories according to the following criteria: financial performance; debt service; initiating legal proceedings.

Financial performance evaluation of a debtor legal entity, non-credit institutions shall be according to internal rules of credit institutions on the basis of scores assigned quantitative and qualitative factors.

Quantitative factors mainly refer to the following indicators, where they can be determined: liquidity, solvency, profitability and risk, including currency risk. At least qualitative factors relate to issues concerning the administration of the entity under review, the quality of shareholders, the guarantees received (other than those that are accepted at reducing exposure to the debtor), the market conditions in which it operates

Indicators for assessing quantitative factors are determined based on data contained in the financial statements of the debtor and determine the category of financial performance and contribute to establishing a classification of loans in the month following the month in which the credit institution shall submit those reports.

If there are credit institutions unable to assess the financial performance of a debtor legal entity, non-credit institutions, it falls directly into the category E.

Frequency with which to determine the category of a debtor's financial performance, legal, non-credit institutions sector coincides with the frequency of the preparers.

Debt service is the ability of the borrower to meet its debt maturity and expressed as number of days of delay in payment by the due date and financial performance highlights the potential economic and financial soundness of an economic entity and is determined based on the data from the financial periodicals.

An economic debt service to the bank will be unique and will be determined according to the way of debt the borrower (capital and interest), whether they come from loans in lei or those in foreign currency. Also an economic debt service is determined by the most senior loans and / or interest paid.

The initiation of legal proceedings is represented by at least one of the following measures adopted for the recovery of claims:

• giving the judgment of the court of bankruptcy proceedings;
• Initiating enforcement proceedings against natural and legal persons.

Credit institutions falls outside the sector borrowers credit institutions in categories of financial performance, which is marked A to E, in descending order of its quality as follows: standard; the observation; substandard; doubtful; loss.

Correspondence of the classification categories and criteria for the classification of loans is determined as follows:

Categorization criteria for classification of credit exposures by credit institutions registered to borrowers outside the system of credit institutions [2].

Table 2.

Financial performance / Debt service	A	B	C	D	E
0-15 days	Standard	In observation	Substandard	Doubtful	Loss
16-30 days	In observation	Substandard	Doubtful	Loss	Loss
31-60 days	Substandard	Doubtful	Loss	Loss	Loss
61-90 days	Doubtful	Loss	Loss	Loss	Loss
minim 91 days	Loss	Loss	Loss	Loss	Loss

If legal proceedings were initiated, all loans to non-banks, regardless of the financial performance of customers, credit is considered "loss";

Categorization criteria for classification of credit exposures recorded institutions credit from other credit institutions [2].

Table 3.

financial performance / debt service		A
banks	credit cooperative organizations	
0 - 7 working days	0 - 30 working days	standard
minim 8 working days	minim 31 working days	loss

If legal proceedings were initiated, all loans are classified as "loss".

Loans to a debtor (risk entities) and / or investment up to this fall in one category classification based on the principle of decommissioning contamination or by considering the weakest of the individual classification categories.

3. AGGREGATE INDICATORS ON CREDIT INSTITUTIONS

Indicators refer to all credit institutions (banks, foreign bank branches, CREDITCOOP). Branches of foreign banks do not report solvency, equity and loan classification.

The indicators are calculated using the financial reporting system (FINREP) and prudential reporting system (COREP) of credit institutions.

In accordance with the law by means credit institutions: banks, Romanian legal entities, branches of foreign banks in Romania and credit cooperatives organizations.

The credit institutions in Romania include credit institutions according to the Register of the National Bank of Romania on 17.10.2014, 40 credit institutions which [3]:

- Banks - 28;
- Banks and savings banks for housing - 2;
- Credit co-operatives - 1;
- Branches of credit institutions from other countries - in September.

Also in the 30 banks operating in Romania are 24 privately owned foreign private owned Romanian four and two banks owned or majority state.

The share of private institutions assets to total assets (IAICT_AP_A) = balance sheet assets of credit institutions with private capital or majority private (including foreign bank branches) / Total assets

IAICT_AP_A December 2009 = 306.1 billion lei / 330.2 billion lei = 92.7 %
IAICT_AP_A December 2010 = 316.7 billion lei /341.9 billion lei = 92.63 %
IAICT_AP_A December 2011 = 324.9 billion lei / 353.9 billion lei = 91.8 %
IAICT_AP_A December 2012 = 334.9 billion lei / 365.6 billion lei = 91.6 %
IAICT_AP_A December 2013 = 331.5 billion lei / 362.3 billion lei = 91.5 %
IAICT_AP_A June 2014 = 322.1 billion lei / 352.4 billion lei = 91.4 %

There is a large share of the assets of credit institutions with private equity and development show a slight decrease.

The share of foreign-owned assets or major institutions in total foreign assets (IAICT_AS_A) = balance sheet assets of credit institutions with foreign capital or majority foreign (including foreign bank branches) / Total assets

IAICT_AS_A December 2009 = 281.7 billion lei / 330.2 billion lei = 85.3 %
IAICT_AS_A December 2010 = 290.9 billion lei /341.9 billion lei = 85.1 %
IAICT_AS_A December 2011 = 293.7 billion lei / 353.9 billion lei = 83.0 %
IAICT_AS_A December 2012 = 328.3 billion lei / 365.6 billion lei = 89.8 %
IAICT_AS_A December 2013 = 326.1 billion lei / 362.3 billion lei = 90.0 %
IAICT_AS_A June 2014 = 282.6 billion lei / 352.4 billion lei = 80.2 %

Also, the share of assets of credit institutions with majority foreign capital is high and progress is decreasing.

Evolution of the main indicators is presented in the table below [4].

Table 3.

INDICATORS	December 2009	December 2010	December 2011	December 2012	December 2013	June 2014
Number of credit institutions	42	42	41	41	40	40
in which foreign banks' branches	10	9	8	8	9	9
Solvency ratio (≥8%) *(%)*	14.67	15.02	14.87	14.94	15.46	16.95
Leverage *(%)*	7.55	8.11	8.07	8.02	7.96	7.87
Overdue and doubtful loans (% of total loans)	1.45	2.23	2.32	-	-	-
Overdue and doubtful loans (% of total assets)	1.01	1.47	1.50	-	-	-
Overdue and doubtful loans (% of total debt)	1.10	1.62	1.64	-	-	-
Claims Impaired (% of total loans)	-	-	-	12.28	11.64	11.42
Claims Impaired (% of total assets)	-	-	-	7.29	6.50	6.45
Claims Impaired (% of total debt)	-	-	-	8.17	7.25	7.24
ROA *(%)*	0.25	-0.16	-0.23	0.55	0.01	0.12
ROE *(%)*	2.89	-1.73	-2.56	5.08	0.13	1.10
Return on core business (%)	156.53	154.2	147.53	180.37	176.85	178.98
Loans / Deposits (%)	112.8	113.46	116.65	114.30	104.59	103.56
Credit risk ratio (%)	15.29	20.89	23.28	29.98	32.14	-
NPL ratio *(%)*	7.89	11.67	14.33	19.08	21.87	-
NPL ratio *(%)*	-	-	-		-	19.19

Leverage = Own Funds 1 / Total assets Average

Receivables impaired (% of total loans) = Impaired Receivables / Total loan portfolio (net)

Claims Impaired (% of total assets) = Claims impaired / Total assets (net)

Claims Impaired (% of total liabilities) = Claims impaired / Total liabilities

ROA (%) = annualized net profit / total assets at the average

ROE (%) = annualized net profit / equity to average

Return on core business (%) = Operating Income / Operating expenses

Loans / Deposits (%) = Loans to customers (gross) / Deposits from customers

Credit risk ratio (%) = Gross exposure and non-bank interest on loans classified doubtful and loss / Total loans and interest, non-bank loans

NPL ratio (%) = Gross exposure and non-bank interest on loans classified loss category 2, where debt service> 90 days and / or where judicial proceedings have been initiated against the operation or the debtor / Total loans and interest, non-bank loans

Since the second quarter of 2014 is no longer calculated indicators "Credit risk ratio 'and' NPL ratio" is determined based on the reports made by all banks: both those using the standard approach in assessing credit risk and those that use models internal ratings.

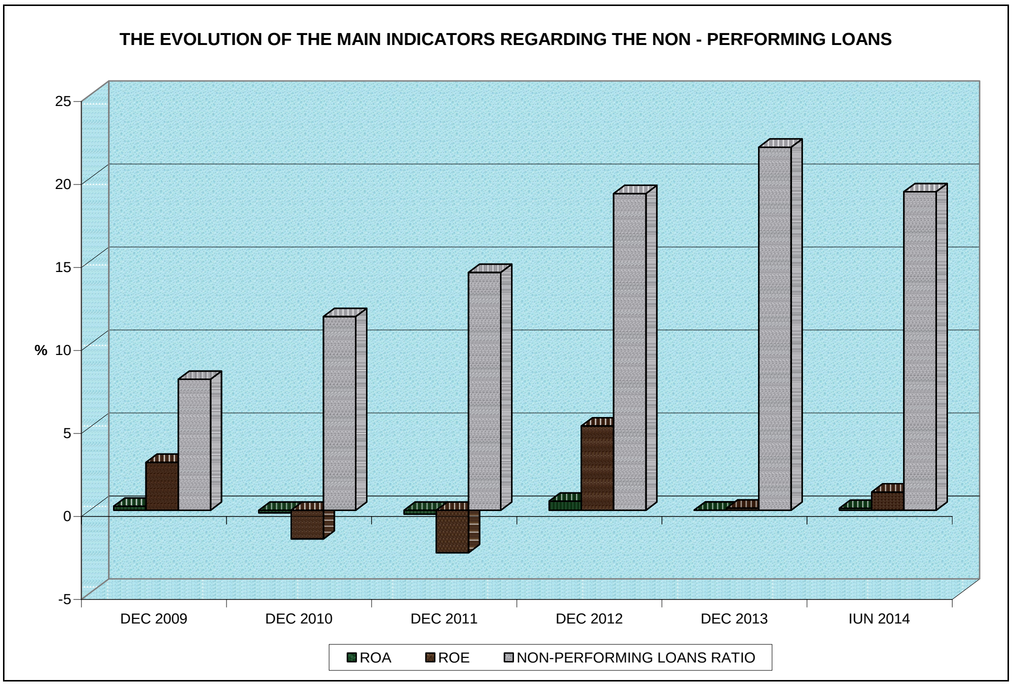

Figure 1. The evolution of the main indicators regarding the non-performing loans

4. CONCLUSIONS

Since 2009 when the global financial crisis were felt in full and in Romania, credit, one of the most complex and significant financial risks faced by credit institutions, has resulted in negative effects and the banks failed to counter and control it only slightly. Known causes are somewhat similar to debtors natural or legal persons.

Thus, some of the individuals who pledged loans have lost their jobs, falling unemployment

For another party or reduced revenue at the time of credit allowed reimbursement, payment of interest and charges for both those who were employed in the public sector and those in the private sector. Recall reduction of salaries for employees in the public sector by 25% since 2010.

Also, a large part of foreign currency loans are loans which seemed very advantageous in much lower interest rates than those in lei, but that had and have much higher costs due to currency depreciation against the major currencies in special Euro (EUR) US Dollar (USD) Swiss Franc (CHF).

The same principal causes or legal persons manifested amid plummeting profitability of entry into bankruptcy. Obviously, banks have spent enforcement procedures, but without success because much of the credit was secured by real estate whose market value has declined greatly, and through their recovery has never provided full recovery of debts impaired.

From the evolution of the main indicators on bad loans can draw the following conclusions:

- Solvency is greater than the minimum (8%), and evolution is increasing;
- Leverage remains within normal limits;
- ROA and ROE values are negative in 2010 and 2011, returning to positive from 2013, but the values are very low;
- Credit risk ratio and NPL is a growing trend which means major financial risks faced by credit institutions in the Romanian banking system, but there are signs that the situation might improve as a decrease NPL in 2014 compared to the previous year, after the period 2009 to 2013 has had a significant growth trend.

In the current banks in Romania clean their balance sheets of bad loans and reorients its funding sources by domestic savings, via an "orderly process of recalibration," said Florin Georgescu recently, senior vice governor of the central bank.

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