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A New Risk Strategy for European Cooperative Banks in Contemporary Economic Crisis

Constantinescu Liliana-Aurora[1], Constantinescu Adrian[2], Dumitrescu Alexandra-Cristina[3]

Abstract: The quality of the banking management and of the risk management represents the essential steps for the insurance, the security and the stability of each bank individually. In this article, the authors intends to underline the main aspects regarding the risk in sustainable development of European credit institutions and the theoretical and practical aspects that can contribute to increasing performance management in credit institutions. In times of crisis, risk management in the banking system has a greater importance than in the normal economic times. The 2011 was a year in which Romania has been hit by the repercussions of the international economic crisis.

Keywords: risk management; risk administration; compound risk; crisis management team; communication during crisis.

JEL classification: G01; G21; G23; G32

1 Introduction

Risk management is an important component of the strategy of a credit institution to obtain a desired level of profit while maintaining an acceptable risk exposure. In the domain of risk management a credit institution guides itself by the operational legal provisions, resolutions, instructions and regulations of the National Bank of Romania, standards, manuals, circulars, instructions, regulations and by its own strategic objectives and rules.

Given the importance and complexity of risk management, in this process are involved all the structures of a credit institution from the Annual General Meeting to each business division.

Risk management in 2011 was made part of the general objectives, so that levels of activity to be mutually supported. This approach allows the credit institution to define and implement a risk management strategy that starts from the top and it is integrated in its routine activities and operations. The management personnel, regardless of its hierarchical level, will manage the activity on principles of risk efficiency. Moreover, the staff as a whole will be trained to be aware of the importance of risk management in achieving their own objectives.

One of the main objectives of the risk management process for 2012-2014 is to ensure a steady flow, with a high quality and with increasing trends of the net revenue even while the international

[1] Associate Professor, Ph.D., Faculty of Finance, banking and accountancy/Department: Finance, banking and accountancy, "Dimitrie Cantemir" Christian University, Romania, Address: 1 Paul Richter Str., Braşov, Romania, Tel.: +40268-474789, Corresponding author: lilianauroracon@yahoo.com.

[2]PhD student, Faculty of Economy Science/Department: Economy, "Lucian Blaga" University, Romania, Address: 10 Victoriei Blvd., Sibiu 550024, Romania, Tel: +40-(269) 21.60.62 / 207, 143, 131, 308, Fax: +40-(269) 21.04.92, e-mail: adicon85@yahoo.com.

[3] PhD student, Faculty of Economy Science/Department: Economy, "Lucian Blaga" University, Romania, Address: 10 Victoriei Blvd., Sibiu 550024, Romania, Tel: +40-(269) 21.60.62 / 207, 143, 131, 308, Fax: +40-(269) 21.04.92, e-mail: alexandra_d_c@yahoo.com.

economic crisis is acutely manifested nationally. This objective will be achieved by ensuring optimal combination between the assets, the liabilities and the financial risks.

2 Credit Risk Strategy and that of Associated Risks

In terms of economics, risk is defined by three main activities, namely:

- ***the analysis activity***, which requires accurate estimation of risk based on customer's initial status parameters and of the transaction for which funding is needed;
- ***the risk prevention activity*** to diminish or even remove the effects;
- ***the ownership of costs activity and potential loss diminish*** generated by risks.

Credit risk strategy **objectives and the associated risks** are:

➢ increase in loan portfolio quality of the credit institution by monitoring the following indicators:

- the importance of "overdue" credits and that of "doubtful" credits in total loan portfolio (gross value) not to exceed 2%;
- the importance of "overdue" credits and that of "doubtful" credits in total equity (gross value) not to exceed 5%;
- the importance of classified credits into the "doubtful" and "loss" categories (gross value) in total loan portfolio not to exceed 5%.

➢ maintaining a net interest margin percentage resulting from dividing the active average interest rate to the liabilities average interest rate of minimum 1,5.

For **the credit risk strategy**, the credit institution seeks the review of lending requirements whenever is needed by internal and external regulations and through which is to be studied:

- analysis of used terms;
- analysis of approval and granting of the credit criteria;
- analysis of credit guarantee policy and of the evaluation practices of securities;
- diversification of loan portfolio by products specific to every type of customer;
- updating of rules and regulations relating to lending activity;
- review the rules and procedures for managing non-performing loans;
- developing and improving IT applications and communication system for the provision of credit and interest overdue reports;
- pursuing unpaid overdue loans and interests by using different methods (negotiating with the client, the rehabilitation credit and the prosecution, enforcement);
- offering credit insurance so that the risk is transferred partially or entirely from the creditor;
- compel the applicants, co-payers and guarantors to engage in credit and other payment obligations arising from all these with all their movable or real estate property.

3 Market Risk Strategy

Interest rate risk is determined and monitored to calculate the potential adverse impact on net interest income, as a result of improper correlation of interest rates on attracted and borrowed sources with interest rates on investments made and the potential losses in net assets.

The levels and dynamics of the interest rate are the result of simultaneous action, converging and contradictory, of several general and specific factors with direct or indirect influences such as: the profit rate, the ratio of demand and credit supply on the market, the risk for loan provider, the duration of the credit, purchase price for attracted sources, volume of owned sources which are not invested in fixed assets, level of inflation, monetary policy, etc.

- **Objectives of the strategy:**
- Minimize interest rate risk depending on the ratio of interest bearing assets and interest bearing liabilities, taking care that its value is close to 1.
- **Market risk strategy includes:**

To achieve the objectives of market risk, a credit institution's strategy includes the following provisions:

- exposure to interest rate risk will be maintained at an appropriate level to the nature and complexity of bank activities within the limits set by its administration;
- implementation of management and supervision procedures of the risk to obtain a large and stable over time interest rate margin, and the profitability and capital value does not change significantly as a result of unexpected fluctuations of interest rates;
- diversification of banking products and commissions related to the core business in order to reduce interest rate risk for their abatement;
- regular review of interest rates on bank's assets and liabilities operations based on analysis and forecasts made by the Administration of assets and liabilities committee on the basis of information on bank market interest rates;
- achieve performance in bank marketing activities to ensure continuous communication between the credit institution and the customer, to facilitate the exchange of messages, information and ideas to achieve the interests of each party.

4. Liquidity Risk Strategy

The main task of bank management is to estimate and to fully cover the optimum liquidity needs. Achieving and maintaining optimum liquidity is a managing requirement whose value is supported only by practice, taking into account the many implications of liquidity risk arising from fluctuations both on profitability and other risks related to the credit institution's activity.

The **objective of a credit institution** for its activity on liquidity risk is represented by maintaining an adequate liquidity activity in terms of ensuring the necessary resources to support the provisions of the budget (business plan) and scheduled loan portfolio growth.

To achieve the **objective of liquidity risk**, credit institution's strategy includes the following provisions:

- the growth of attracted sources of non-bank customers and introduction of new savings products with high stability level on long and average periods, benefiting from competitive rates and adequate promotion;
- the implementation of the credit institution of a value of greater liquidity than 1 on each maturity band;

- the immediate liquidity indicator made by the credit institution must be higher than 20%;
- maintaining stable relations with suppliers and financing sources and keeping an active position on the interbank market;

5 Operational Risk Strategy

In the category of operational risk factors included:

- the preparation, number of employees and safety measures taken at each workplace;
- the products and the banking services, operating practices adopted or their practice error;
- the structure of the internal procedures used or the faulty application of provisions;
- the weaknesses in computer and communications infrastructure;
- disruptions in activity and system failures;
- internal and external fraud;
- improper application of legal and contractual provisions.

Operational risk management is carried out continuously in the credit institution taking into account the risk factors.

For proper operational risk management by the credit institution, **the objectives are**:

- ensure work continuity regardless of the type of disruptive event;
- improve operational efficiency and continual internal control;
- improve the quality of customer services;
- increased training of employees;
- effective management of information and human resources in the credit institution;
- the credit institution must have at all times its own funds to cover operational risk they are exposed to.

To achieve the objectives for the institution's **operational risk the strategy** of the credit institution includes:

- regular review of management processes and operational risk measurement;
- developing a technology based on web / intranet technology to collect operational risk reports throughout the bank;
- establishing rigorous operational and internal control cultures, including separation of duties and responsibilities specifications for every job.

6 Reputational Risk Strategy

Damaging reputational risk is caused by the credit institution's image as a result of negative publicity made, business practices and / or individuals associated with them, or the management staff, regardless of its conformity with the reality, producing a loss of confidence in the integrity of the bank from clients, which leads to the failure in reaching the expected profits. The potential impact of reputational risk to the activity of the credit institution may consist of:

- image deterioration or loss of customer confidence, third-party counterparty banks, media and so on in the bank;
- production of direct or indirect financial loss, measurable or not;
- failure to launch new products / new services;
- failure in reaching estimated profits and / or reduction of the market share.

For the proper management of reputational risk by a credit institution, **the objectives** are:

- improve the image and avoid direct or indirect damage to the image and reputation;

- avoid disclosure of secret or confidential information and use of information by their staff to obtain personal benefits or denigrating the credit institution.

To achieve the objectives for the institution's operational risk **the strategy** of the credit institution includes:

- defining image of the bank attributes and methods of image enhancement;
- regular review of policies and procedures to know more about clients with the purpose of avoiding entering into business relations with customers who have a history of fraudulent transactions involved in money laundering, major incidents of pay, clients who don't pay on time, or involved in illegal activities;
- IT application development process to improve the identification of unusual and / or suspicious transactions;
- preparation of front-office staff to advise clients in making informed decisions, correct and consistent with their needs regarding the purchase or use of banking products and services offered by a credit institutions;
- developing a working procedure for receiving complaints from customers and solving them;
- preparation of the staff code of conduct from the credit institution.

7 Conclusions

An efficient banking strategy should include both software and banking risk management procedures that aim, in fact at minimizing the likelihood of such risks and potential exposure of the bank, because the main objective of these policies is to minimize losses or additional expenses incurred by the bank and the central objective of obtaining a banking activity is higher profit for shareholders.

In Romania, all banks have faced financial instability factors in a general context of instability caused by the transition process. The transition meant for the Romanian banks change the statutes (operating as joint stock companies), operating in the legal framework (law allowing a wide range of engaging in financial transactions), competition from other financial institutions (investment funds) and other banks (Romanian, created after 1990 and foreign) direct refinancing reduction by the central bank, continual change of prudential rules by BNR and the deterioration of the financial situation of most major customers. In these circumstances, the management of banks, implementing appropriate risk management policies becomes a necessity, and also the assimilation by the employees of new techniques and tools for risk management.

All credit institutions must improve their understanding and practice of banking risk management to be able to successfully manage different product lines. If the bank risk management and global management system are effective, then the credit institution will be successful. Credit institutions can successfully manage the banking risks if they recognize the strategic role of risks, if they use the analysis and management paradigm to increase efficiency.

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