CONSIDERATIONS REGARDING THE MANAGEMENT STRATEGIES OF BANK RISKS

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Abstract: The study summarizes what it means banking risks, the main risk management strategies. The complexity of the business environment, liberalization and internationalization of financial flows, brings rapid innovation, diversified financial markets, new opportunities but multiplied risks. Banks establish the types of risks they are prepared to take and the threshold at which risk is considered significant. The process of determining the risks that are taken includes the nature, the scale and the complexity of banks.

Key-Words: banks, banking risks, the strategy of the banks, profit, credit risk, credit risk management.

1. Considerations regarding the types of banking risks

The bank's strategy regarding management of relevant risk should determine the significant relation between risk and profit which the bank considers acceptable.

Banking risks are determined by the manifestation of a complex of factors that depend on: the overall evolution of the economy, changes related to the bank's organization and structure, taking financial decisions, political and economic conditions. Production of banking risks may cause fall in profits and income of shareholders, ultimately exiting the business of the bank or by taking her to a stronger bank, either through bankruptcy, according to banking theory differing risk typology by the intensity of action and consequences that they generate.

Identifying, assessing, monitoring and managing risks, besides the analysis of financial records and verification of compliance with prudential limits imposed entails permanent and open communication between the bank subdivisions.

Banks establish the types of risks they are prepared to take and the threshold at which risk is considered significant. In determining the risks are taken into account the nature, scale and complexity of banks.

Risk represents "the potential damage that is incurred by the heritage, interests and activity of the entity." [1]. In a minimalist definition, the risk is defined as the "probability of occurrence of an event with adverse consequences to the subject"[2]. Other specialists present the risk being "a potential adverse deviation from the expected results." In the paper "Le gestion bancaire et financière control" specialists Michael Rouch and Gerard Naullen defined risk being an uncertainty given a commitment, with a probability of gain or loss or degradation or loss latter.

National Bank of Romania classifies risks into the following categories [3]:

- Credit risk
- Risks associated with credit risk - in which there are the following subdivisions:
  - The counterparty risk
  - The country risk
  - The concentration risk
  - The residual risk
  - The settlement risk

The market risk - there are the following subdivisions:

- Interest rate risk of trading book (in the trading book activities)

- Interest rate risk of the banking book (from non-trading activities)
- The risk of price changing
- The currency risk

- The cash flow risk
- The operational risk
- The reputational risk

The exposure limit represents the maximum capacity of the bank to make commitments in/off balance sheet, over a period of time determined capacity in conjunction with:

- the level of own funds existing and projected;
- the structure and level of resources and existing and planned investments to achieve;
- the level of estimated profit to be achieved.

Committee on Banking Supervision established in Basel regulated the role and organization of the risk management function. According to documents published by it, there are four main functions in risk management: identification, assessment, monitoring and controlling / reducing risk.

2. The bank's strategy regarding management of banks risk

The banks appetite for to certain investments (with a high level of risk) increases the risk but banking prudence should be the fundamental principle governing banking.

An efficient bank management should include bank strategies and bank risk management programs in order to minimize them.

Risk identification, and their location is the first step in a comprehensive risk management process within its associated risks must be determined for each type of product and banking service.

Once identified the associated risks is necessary to develop scenarios in order to determine frequency and amplitude of each type of risk associated [4]

Thus, credit institutions must assume all risks arising as a result of the process of obtaining the profit knowing that:

- must comply with prudential measures imposed by the national regulatory authority;
- expected profit is commensurate with the risk exposure;
- potential losses should not affect credit institution in a precarious financial situation, knowing that they must be covered by provisions or profit;

The risk should be sized so the suffered loss could be considered as normal and the image bank (national and international market) does not suffer.

Risk management involves prevention, monitoring and limiting banks' exposure to risk and determining the level of assumption of some risks, so that, at the time of their impact, the banks should have the capacity to overcome the negative financial impact that they may cause.

Risk management processes involve specific techniques for quantifying and monitoring risks, based on a set of risk management principles harmonized with international best practices.

We can say that the process of risk management is a continuous process, designed in close connection with the business strategy, with active involvement of the management structure, taking into account current and potential risks that may affect the Bank's activities and in particular its capital adequacy.

3. The strategy regarding Credit Risk Management

The bank's strategies must be based on prevention and mitigation policies of banking risks and default bank losses. To manage credit risk in the loan portfolio a bank has to consider the risk assessment for the portfolio of loans and financial instruments, including derivatives, and comply with the limits of exposure to credit risk, namely:

- ceilings and limit exposure to domestic and foreign banks and registered in balance sheet assets and off-balance;
- exposure limits on the guarantee funds and insurance companies;

- limits on concentration risk arising from non-banking operations recorded in the balance sheet clientele and outside it [5].

The credit risk strategy establishes:

- general policy requirements and procedures on lending through the credit risk approach, having regard to the acceptable between risk and profit, whilst ensuring business continuity are sound and prudent
- lines to follow in order to implement the risk profile chosen by the policies and procedures of lending and credit risk management.

In order to obtain the profit, according to specialists in the field of credit institutions can implement a number of principles of credit risk management:

- checking and monitoring loans - the ambiguity of information is present on lending markets because lenders have little information about investment opportunities and activities borrowers. To achieve effective checks, credit institutions shall collect solid information from potential borrowers. Effective checks and collecting information is together, an important principle of credit risk management.
- establishing a long term relationship with customers - past activity analysis of a customer who has had a current account or savings account or other credit from a bank, for a long time, it enables the creditor to know certain aspects about it. A long-term relationship and customer benefits not only the bank. A customer who has a previous connection with the bank will easily get a loan at a lower interest rate because the bank assessment of whether the debtor future low credit risk and therefore lower costs for monitoring records borrower.
- loan commitments: the commitment of the bank to provide to a firm lending a certain amount at an interest rate predetermined requires that firm obligation to consistently provide bank information on its financial situation, thus reducing bank to collect information, as well as credit risks involved. The advantage of the company is to have a constant source of lending, and the advantage is that bank lending commitment develops a long-term relationship with the customer, facilitating wider access to customer information.
- rationalizing credit: This principle is the bank's refusal to grant credits even if customers are willing to pay fixed interest rate, or even a higher rate. Streamline loans is twofold: the first is when the creditor refuses to grant loans of any value to a client, even if it is willing to pay a higher interest rate; the second occurs when the lender restricts the size of the loan at a lower value than desired by the customer.

Preventive management of credit risk involves the organization of the lending process, from defining the credit policy and ending with monitoring and controlling credit granted based on anticipating risks in order to reduce or eliminate their undesirable effects. As not performing loans continues to grow, reaching over 24% in the first quarter of 2015, banks are concerned with the quality of their loan portfolio and the availability of capital.

The activity of managing loan risks is referring both to global and individual lending, each component having its specific role in the lending business and general management.

4. The strategy regarding Liquidity Risk Management

Liquidity risk expresses the current or future risk of the process of negatively affecting profits and capital and is determined by the bank's inability to meet its obligations at their maturity since the source of deposits that provide funding increases the volatility of the fund, as some creditors are more sensitive to events market than others; liquidity risk lies in the bank's inability to meet its payment obligations in the short term, without this resulting in costs or losses that cannot be supported by the Bank[7].

Among the causes that leading to the risk of bank liquidity could be mentioned: the real economic situation, influence of the mass-media, financial indiscipline of the customers, dependence on the financial market, the maturity mismatch between deposits and loans.

The main objective of the bank in the event of a liquidity crisis is to honor its commitments under optimum cost / benefit and ensuring setting minimum reserve requirements.

The main objectives of the strategy in liquidity risk management are:

- prevention and prevention of crisis situations, by defining liquidity risk profile of the limited time horizon and monitor the liquidity indicators in both the level of risk accepted by the NBR regulations, and by internal regulations.

- developing / adopting action plans for contingencies and identifying solutions for action to overcome / remedy possible period of liquidity crisis the bank by maintaining liquidity in the short and medium term to an optimal level, coupled with its strategy of risk so it can ensure prudent asset growth and honoring its obligations without inducing unacceptable costs.

The objective of liquidity risk management is to maintain sufficient liquidity and to compensate for expected and unexpected fluctuations of balance elements and permanent coverage of the bank's outstanding payment obligations.

In Romania, liquidity risk management has been improved, mainly by completing the regulatory framework in the second half of 2010, detailing existing requirements regarding liquidity reserve in the context of new international requirements. Liquidity indicators of the banking sector shows appropriate values, where Basel III introduces two new standards for liquidity risk: *the liquidity coverage ratio* and *the net stable funding ratio*.

5. The strategy regarding risk market management

According to the NBR Regulation no.18 / 2009 regarding the management of the activities of credit institutions, the internal assessment of capital adequacy and conditions for outsourcing their activities, with additions and changes:

- Market risk is the current or future risk of adverse outcome on earnings caused by market fluctuations in prices of equity securities and interest rate in respect of the activities belonging to the trading portfolio and exchange rate fluctuations and commodity prices for all bank activity;

- Interest rate risk is the risk of negatively affecting current or future earnings and capital due to adverse changes in interest rates.

Risk strategy (in terms of market risk) mainly envisages the major components of market risk, namely:

- the interest rate risk;
- the currency risk.

Risk strategy (in terms of market risk) envisages, mainly, the major components of market risk, ie: interest rate risk; currency risk; daily management of foreign exchange positions and framing in the regulated limits on each currency; permanent monitoring of market developments that may affect the risk profile of the Bank; measuring the loss in terms of vulnerability to market volatility through analysis based scenarios and stress tests; predicting and limiting potential losses due to volatility in exchange rates using the model Value at Risk (VaR); limits "stop-loss" established at transaction-level, on the dealer and total transactions over a period of time that are regularly reported in the Bank's management.

Banks should consider a proper management of lending and deposit rates combined with action to promote products assets and liabilities, to achieve both an increase in workload and ensure a gap of interest optimally and ensure a balanced adjusted individual currency positions and the total currency position.

The market risk strategy aims to achieve a portfolio with low sensitivity to changes in interest rates and the exchange rate and achieving the targets set in the risk profile. These goals are achieved by managing interest margin calculation and analysis of indicators of interest rate risk management and foreign exchange position of banks' foreign exchange risk ratio analysis.

The process of analyze the market's risk:

- to be coherent with the risk appetite, risk profile and level of capitalization systemic importance of the credit institution;

- to take into account market and macroeconomic conditions, and the risk of significant deterioration in market liquidity;

- to describe clearly the roles and responsibilities of identifying, measuring, monitoring and controlling market risk.

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6. Conclusion

The bank's strategy regarding the management of significant risk should determine relation between risk and profit which the bank considers acceptable in terms of ensuring the continuity of prudent banking on base [8].

Banks must have, as I mentioned before, relevant information on economic and financial situation of borrowers, the economic nature of operations, the moral reputation of debtors, their creditworthiness etc.

In order to prevent banking risks, banks must respect a number of regulations. Risk management must link between overall management and internal management. The continued growth of bank risk in the contemporary era, along with intensification of cooperation led to the internationalization of the regulations for the purposes of drawing up national rules according to the principles accepted by many countries, such international groups study organized by the Bank for International Settlements in Basel or application Community rules, developed as European directives and European Economic Union system.

Basel III is the third agreement concluded in Basel and present regulations that improve communication and cooperation between supervisor authorities in strengthening management practices liquidity risks that come from payment obligations and the settlement both internally and externally. The new standards are designed to improve the ability of the banking sector through a higher risk management under the coordinates of enhanced governance and increased transparency conditions. The impact of Basel III on the European banking system is significant.

In conclusion, we can say that the risk is not an isolated event; it is basically the foundation of all business because our world, without borders and strongly globalized causes rapid transfer of risk from one country to another.

In order to obtain profit, commercial banks have to assume the specific risks of this process, under caution to consider prudential requirements imposed by the national regulatory authority, justification exposure to the risk assumed, sizing risk so the loss produced by its materialization could be deemed normal for the activity and the bank's internal and external image. Banks must do permanent monitoring of risks. Any bank have to adopt decisions related to the results and the risks it wishes to undertake to reach these levels, the knowledge and the application of key measures for deciding the future of the relationship profit-risk, a relation that must be a central objective of bank.

Risk managers take risky decisions because "the future is not unique and perfectly predictable". [10] Connection with subjects as Economic Statistics and Economic Forecasts can help reduce the risk by using explorative models [11].

Banks and financial institutions need to improve their understanding and practice of bank risk management in order to be able to successfully manage different types of products. If the process of bank risk management and global management system are effective, then the bank will be successful. Banks can successfully manage bank risks if they recognize the strategic role of risk if they use the paradigm of analysis and management to increase efficiency.

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