GENERAL NOTIONS ON BANKING RISKS

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Abstract

Risk can be defined as an accident with negative consequences for economic agent. Is influenced by events or phenomena that act on business companies, the expression failure to gain or loss in economic transactions pursued. Banking risks constitute risks facing banks in the implementation of current operations. Credit risk is the degree of loss suffered by a bank, where the customer bankrupt and unable to pay its obligations to it.

The following are specific aspects of risk, namely: definition and content of the concept of risk, the general aspects of banking risks, financial market risks in the context of banking.

Key words: risk, uncertainty, adverse event, credit risk, financial markets.

1. Definition and content of the risk concept

The risk represents a social, economic and politic category, whose origin is in uncertainty that may occur due to damage hesitation in decision making. Risk can become a brake on the development and expansion of economic life by reducing the volume of business and incurring property damage.

In a general sense, risk reflects a chance of an adverse event to occur, as a possibility of loss or damage, danger, jeopardy.

From economic and social life point of view, risk is the chance or possibility of occurrence of an adverse event related to decision variables and involves knowledge of the occurrence probability of events. The risk represents a state with negative effects that can happen.

Defining and measuring risk require the use of statistical concepts such as: probability distributions (the more narrow is the probability distribution of future returns, the lower is the investment risk), estimated return (expected), standard deviation, “medium variant” criterion, beta coefficient, etc.

Risk can not be expressed or removed because it exists in business world, in the economic, social and political society, there are some activities that increase risk.

The risk reflects the occurrence possibility of undesirable events, and the more negative or unintended consequences are, then even more the decision taken is risky.

Two categories of risks can be defined, in social, economic and political terms:
- Catastrophic risks, objectives, which are the consequence of accidental events or tragic events (floods, wars, earthquakes, hurricanes, fires), in which case there is no likelihood of loss capital to be recovered;
- Hedge risks related to decisions, representing events with probability to occur, depending on the environment in which they operate.

The risk represents a possible and unwanted event, predictable or unpredictable, that can produce material or moral losses, manifested between people relationships, between man and nature, man striving to create the means of prevention, reduction, mitigation or removal of risk permanent effect.

The wide acceptance of risk is the possibility of a loss to occur, in the case of transactions as a result of the appearance of unforeseen events. The causes that generate risks are of commercial or noncommercial nature. To avoid or mitigate these risks it requires knowledge of domestic and international law and specific usage to certain areas.

2. Banking risks, general issues

Commercial, private and national banks execute operations related to universal loans to industrial, commercial, etc. enterprises, predominantly from cash account, obtained in the form of deposits. It highlights four groups of banking operations: passive operations, active operations, banking services and banks' own operations.

Passive operations are called to mobilize financial means, which, in turn, are used to finance active operations. They include accepting deposits (spot, forward), attracting loans and issue securities.

Bank active operations include loans and securities operations. Banks conduct acceptance operations, currency transactions, mortgage transactions. Lending operations can be classified by insurance, repayment term, repayment mode, payment mode of interest, debtor type.

Depending on banks’ activities and strategies they adopt, and on the policies which they apply, banks are exposed to various specific banking activity risks, and are therefore known as banking risks.

To decrease the possibility of obtaining excessive profits, but especially to establish a prudential banking framework, banking law recognizes the right of the National Bank of Romania (NBR) as the sole authority in this area. Thus the National Bank of Romania (BNR) is the only institution issuing the authorization to operate in this area and also oblige the opening of accounts by any bank at NBR and at the establishment of funds of minimum reserves in the limit of 20% from the gross profit up to the social capital level.

Bank risk being generated by many operations and procedures should be viewed as a conglomerate or complex of risks, often interrelated, in that they have common causes. These operations and procedures generate a permanent risk exposure.

The stability of banks that operate on various financial market segments is directly influenced by the approach to risk management. The existence of an efficient risk management generates positive effects for both the bank and its customers. The bank benefits consist of: decreased level of unexpected losses, optimization of revenues, expected expenditures and risk premiums, volatility reduction of financial results etc. Besides the increase of bank’s financial stability, a number of benefits result for customers as well: optimization of tariffs, increasing the quality, diversification degree and promptness of their services, increase in the protection of customers’ interests.

In accordance with the NBR’s recommendations, commercial banks in Romania identify the following risk groups: credit risk, market risk (including currency risk), operational risk (including legal risk), risks directing assets and liabilities (including liquidity risk and interest rate risk), the risk of external events and strategic risk.
Given the importance of bank risk management, NRB developed and implemented a number of laws designed to ensure a prudent approach by banks in Romania, of inherent risks resulted from their activities. Commercial banks comply fully with all requests submitted by NBR, namely: training fund reserves mandatory for deposits, formation of reserves for losses on loans, maintaining the credit portfolio structure in accordance with the credit policy, maintaining risk weighted capital in the limits set by NBR and compliance limits towards the open foreign currency position, bank liquidity, loans etc.

3. Banking risks in the context of financial market

One of the main functions of modern banking system focused on economic market activity lies in the risk management. Banking system problems that arise due to mismanagement of resources on one hand and investment on the other hand, occur in all economies.

Bankruptcies jeopardize the stability of the financial system also in countries where surveillance system is well developed. Institutions operating on the global market have to deal with increased volatility and the effects of crises that may be transmitted between different financial centers due to systemic risk. This phenomenon occurred in close connection with the higher volume of transactions in derivatives such as futures, swaps, options.

Risk represents those situations where the outside or inside factors of a credit institution act in a manner that can not be predicted with effects on market values.

Banking financial risk assessment is made by reference to a landmark called benchmark. Relative to the benchmark, risk definition has two options, first we understand the danger of a loss occurrence (risk down side) or the opportunity for a gain (up-side potential).

Financial markets development facilitated by the growth of derivative financial instruments transactions and ITC development has resulted in three main ways: increasing exposure to market risk and risk intermediation; perpetuating management activity assets minus passive and the emergence of new risk situations; financing and market risk modeling by using statistical and mathematical tools.

Managing banking risks shows he following components: risk identification is aiming to detect the risk positions that can influence the outcome of the credit institution; risk assessment and measurement requires numerical expression of effects that can occur regarding financial institution profit; realization of a relevant risk management policy due to the application of specific tools; risk control should be conducted to see if the financial and banking regulations have been complied with and whether the types of management tools have been properly used; performance analysis involves measuring their due coverage and risk exposures.

Conclusions

The risk management is one of the main functions of modern banking system focused on economic market activity. Banking system problems that arise due to mismanagement of resources on one hand and investment on the other hand, occur in all economies.

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