

MULTIPLE CHALLENGES OF RISK MANAGEMENT IN EU CREDIT INSTITUTIONS

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Abstract: *This paper is intended to be a significant insight into risk management issues by describing the main types of such risks and by providing management and evaluation procedures of significant risks into some active banking companies in Romania. 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. Using strategies against risks, implementing procedures to monitor and control risks, risk assessment and quantification can substantially reduce the financial losses of a company or those of a financial institution. Risk management is an integral part of all decision making and business processes from credit institutions, its purpose being to protect their sustainable development. The innovations on the financial market, the internationalization of the specific operations, and the pressure of the competition are just a few arguments that impose a permanent supervision of the general and specific risks. This is the main reason why is compulsory to find new methods of managing risks, to keep in consideration the identification, evaluation of the management and the control of the banking system and of each bank.*

Key words: *risk management, performance management, risk administration, compound risk, crisis management team, communication during crisis.*

1. Introduction

This paper is intended to be a significant insight into risk management issues by describing the main types of such risks and by providing management and evaluation procedures of significant risks into some active banking companies in Romania.

In times of crisis, risk management in the banking system has a greater importance than in the normal economic times. The 2009 was a year in which Romania has been hit by the repercussions of the international economic crisis.

Using strategies against risks, implementing procedures to monitor and control risks, risk assessment and quantification can substantially reduce the financial losses of a company or those of a financial institution.

Risk management is an integral part of all decision making and business processes from credit institutions, its purpose being to protect their sustainable development.

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2. Alternative plans for unpredicted situations in significant risk management in the cooperative bank of Unirea Braşov

The crisis is a period in the evolution of a credit institution, characterized by increased accumulation of difficulties, the outbreak of conflict stress, the onset of strong pressures from outside, making difficult its normal functioning. Managers and employees of the credit institution which enters into crises are suddenly deprived of the landmarks, as it is, they are removed from their normal bases of decision making and information so that it is difficult for them to measure and analyze the sum of new elements issued the crisis.

A crisis occurs in circumstances where the credit institution is unable to overcome, with the applicable means and strategies in normal times, a certain situation.

In a crisis, the credit institution goes through several stages:

- ❖ The first stage, the impact stage, would be one in which there is an unexpected event that takes by surprise the credit institution and this automatically responds with its own routine of problem-solving;
- ❖ In the next stage, it appears that we can not solve the problem by the means and strategies applicable in a situation of normality;
- ❖ In stage 3, on the background of crisis augmentation, the management structure seeks to put at work all available resources to solve the problem;
- ❖ stage 4, is the active stage of crisis. The duration of this stage and the way in which it is solved depends on the speed of reaction of the crisis management team and the quality of alternative plans used for the crisis situations.

Alternative plans for crisis situations have as purpose:

- making the situation stable;
- limiting the damages;
- functional restoration.

The alternative plans for crises situations, drawn by Cooperative Bank Unirea Braşov include the following principles:

- identifying the causes that generated the crisis;
- formation of teams with specific tasks and more decision-making power;
- the attempt to rapidly remove the outbreaks of crisis;
- maintaining the image of the institution as being a financially solid one;
- prepare post-crisis action plans for implementation.

These principles lead to the achievement of action plans that will be used in unplanned situations.

The forecast of crisis situations for significant risks was made by conducting crisis scenarios aimed at significant risk assessment for 2011.

A. Crisis management team

The strategy of Cooperative Bank Unirea Braşov in handling critical situations, rely primarily on bank specialists. It is considers particularly important to set up a team, selected from bank managers, who have authority in a crisis situation and to monitor the implementation of alternative plans.

For Cooperative Bank Unirea Braşov in the event of a crisis generated by the significant risks development, the crisis management team will consist of:

- CEO
- Deputy Manager
- Chief Accountant

The crisis management team members have the following duties and decision making obligations:

- The CEO is the coordinator of the crisis management team and decides:
 - ✓ the moment when to activate the alternative plan in crisis situations;
 - ✓ the specific responsibilities of each team member;
 - ✓ the specific responsibilities of each member of the support team;
 - ✓ to establish and revise, as appropriate, measures taken to remedy the situation and the getting into normality;
- The Deputy Manager has the following tasks and decision powers:
 - ✓ to coordinate the support team;
 - ✓ to ensure an uninterrupted information flow allowing rapid decisions to be made in order to monitor efficiently the situation.
- The Chief Accountant has the following tasks and powers of decision:
 - ✓ is constantly supervising the evolution of the situation;
 - ✓ makes recommendations of measures to be taken locally.
 - ✓ makes analysis to establish the limits for the outbreaks of crisis;

The crisis management team will receive the help of a *support team* that has the role to ensure an uninterrupted flow of information and to offer it to the crisis management team to ensure the premises for taking quick decisions for the effective management of the situation.

B. Activation of the crisis management team

In terms of when is activated the crisis management team, there are three basic types of strategies:

- intervention in the moment of appearance of crisis;
- intervention during crisis;
- lack of intervention.

The strategy of Unirea Braşov Cooperative Bank regarding the moment of crisis management team activation into the actual moment the crisis, respectively the first stage, the stage in which it is established that no problem can be solved by the means and strategies applicable in a situation of normality.

The activation of the crisis management team is made by the CEO.

The first measure taken by the management crisis team is to assign specific tasks to each member of the crisis management team, according to their specialization. Assignment will be considered, in particular, for the control of all activities and channeling all human, material and financial resources available to remedy the situation towards normality.

Furthermore, tasks are assigned to the support team, tasks that mainly involve:

- monitoring the functioning of information flow;
- centralizing and managing data and information according to requirements set by the crisis management team;
- continual information brought to the crisis management team of the evolution of the situation and all the measures undertaken locally, etc.

Once activated, the crisis management team will meet daily or whenever needed to analyze the situation and take appropriate measures. These meetings are of great importance because the evolution of the situation depends largely on prompt response of the team members.

C. Objectives the crisis management team seeks to achieve

- Identifying the causes that generated the crisis;
- Removing rapid outbreaks of crisis where it is possible;
- Ensuring consistent liquidities and obtaining important amounts of cash;
- Maintaining a sound financial institution image;

- Prepare for implementing post-crisis action plans;
- Focusing on improving services;
- Focus on maintaining customer loyalty;
- Collection of conclusions based on analysis of the occurred situation, which should lead to improvement and refinement of control and risk management policy and to reconsider investments policies and to attract resources

Measures adopted to full the objectives

Measures of isolation and control of the existing situation

- based on the information received and processed by the support team, the outstanding loan portfolio will be determined and detailed and lists of all relevant information will be prepared, which will include measures taken to means of collecting outstanding debts;
- analysis of risk factors and causes that have generated the deterioration of the quality of the loan portfolio in order to establish concrete measures to be taken to counteract the negative trend;
- analysis of credit concentrations on debtor or debtors groups broken down by types of loans, segments of economic activity, age of debt, geographical areas;
- estimate the need for provisions to cover credit risk and their impact on the profit and loss account to determine how the cooperative bank is affected by the situation;
- based on received and processed information by our support team, the following will be analyze:
 - degree of instability of interest rates;
 - credit interest-bearing loan operations level;
 - rate structure (fixed, variable) and installments bottlenecks;
 - possible developments of interest rates;
- net profit structure;
- share in total revenue from interest income sources.
- establish an optimal level of liquidity;
- daily monitoring of employment in the optimal level of liquidity;
- minimizing operating expenses and supervision costs;
- dialogues with major customers to negotiate interest rates to meet their expectations and at the same time being considered acceptable for Unirea Braşov Cooperative Bank
- based on received and processed information by our support team we will determine the level of losses caused by fraud, preparing a detailed list of all relevant information, including:
 - date on which the event was known;
 - a detailed description of the event;
 - employment in a risk category;
 - known level of loss;
 - estimate of expected loss;
 - guilty person.
- analysis of risk factors and causes that have generated the fraud in order to establish concrete measures to be taken;
- establishing and implementing concrete actions to restore confidence in the stability of the bank and its staff;
- filing criminal complaint against all guilty people and request the competent authorities to take precautionary measures against those responsible;
- provide servicing for all customers and avoid possible appointments for other days;
- the presence of the management team of Unirea Braşov Cooperative Bank the working day with customers to create increasing confidence;
- the dialogue with key customers to ensure no risk on their ability to pay Unirea Braşov Cooperative Bank;
- making announcements in the media or eliminate programs that lead to panic.

Post-crisis recovery plan

In order to recover after the crisis and entering a state of normalcy in the conduct of all activities of the Unirea Braşov Cooperative Bank, the crisis management team will require data and information from the support team to establish measures for entry into normality.

Measures for recovery and entry into normality will refer mainly to:

- granting of new loans on a sound basis, to eligible customers;
- intensification and diversification of the recovery of outstanding debts amicably or by enforcement of guarantees;
- tracking of compliance with contract throughout the loan contract;
- reduce exposure for certain loans by creating supplementary personal or real guaranties;
- ensure better correlation between the mature assets and mature liabilities.
- balance sheet structure management so that fluctuations in exchange rates of assets and liabilities to be well correlated to contribute to earnings even in a changing environment;
- avoid exposure to interest rate risk, by keeping it under strict control;
- improve systems for detecting faults at staff in the appropriate moments;
- promote the creation of a favorable psychological climate in the team of the cooperative bank, through which every employee to feel both protected and verified;
- permanent control of sharing the responsibilities;
- a system of checking the staff from the Unirea Braşov Cooperative Bank;
- intensify the fight against fraud in cash desk.

4. Communication during crisis

Communication occurs during the crisis, as being the most important component of conflict solving and image management.

The decisive factor, with a role to initiate, support and boost of communication is the CEO of Unirea Braşov Cooperative Bank.

Communication within Unirea Braşov Cooperative Bank

Crises in general and banking in particular, have some common characteristics:

- many crises are inevitable due to the generating factors;
- crises can affect the security of bank, but most have only public interest implications concerning value, tradition, rights.
- crisis begins with a state of confusion and lack of control and develops at an unpredictable speed;
- the time for solving the crisis is inversely proportional to the number and quality of information and directly proportional to the promptitude of obtaining it.

In a crisis all the provisions, on how to carry out activities during the crisis, will be given by the CEO to eliminate the possibility of contradictory provisions which in such a situation may exacerbate tensions within the cooperative bank.

Communication with the outside

In crisis situations, an efficient and effective communication depends on the precision and accuracy of the message.

Therefore the messages will be sent to the media or to any natural or legal person outside the cooperative bank only by the CEO of the Unirea Braşov Cooperative Bank.

In his absence, the media messaging will be sent by the Deputy Manager. The other

bank employees, regardless of hierarchical level on which they stand, will refuse politely but firmly any comment and will indicate, if applicable, how's the bank management will be contacted.

The CEO of Unirea Braşov Cooperative Bank will ensure that the intended message is delivered and what the receiver understands is as close as possible to his intentions.

Many factors are to be taken into account, among which the most important ones are:

- **time** - to keep the image (when image is not deteriorated yet) or rather to combat a negative image, it is important to communicate with the outside very quickly because, as time passes, the more it reinforces a negative image of the bank;
- **accuracy of information provided** - to combat rumors, information sent to media must be accurate and any allegations about the crisis, exit arrangements and the expected time to overcome it must be proven and realistic.
- **location** - the choice of where we communicate with the outside is very important. The place chosen for the communication may be the one reflecting the beginning of the crisis (if it is a work point) or at the Unirea Braşov Cooperative Bank headquarters;
- **relationship with the recipients of the communicated message** - face to face communication is recommended because of its spontaneity, developing positive communicative relationships, the misunderstanding of the delivered message is more unlikely to happen.

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 paid by the bank, the central objective of a banking activity is obtaining higher profit for shareholders.

But these two objectives are not always consistent. It is possible, in some cases, that the cost of implementing and operating procedures relating to the management of risks to be greater than potential exposure to risk, which only means that, these programs should be selected according to the efficiency criteria. In other cases, the bank's strategy may involve additional risks or taking some new risks. In this case, the decision must always have to consider the additional costs necessary to ensure adequate protection and greater potential losses. But if the decision is such, then minimizing the banking risks should, under no circumstances, become a goal in itself.

The importance of bank risk management, however, is not limited to minimizing costs. Permanent concern of the management to minimize exposure to risk has positive effects on employees' behavior that become more rigorous and conscientious in fulfilling their job tasks. We could not ignore the psychological effect to deter fraudulent activities.

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 changing 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.

In conclusion, because the banking risks are a source of unforeseen expenses, their proper management to stabilize revenues thought time will act as a shock absorber. At the same time, strengthening the value of bank shares can only be achieved through effective communication with financial markets and implementation of appropriate management of banking risks.

All banks and financial 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 is effective, then the bank will be successful. Banks can successfully manage the risks if they recognize the strategic role of risk and if they use the analysis and management paradigm to increase efficiency.

5. 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.

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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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