THE BANK RISKS MANAGEMENT – A NEW APPROACH

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Abstract
The financial institutions are faced with both the specific risks arising from activities conducted on the financial market and common risk for all businesses and individuals. In the current financial markets we see the increasing use of derivative products (swaps, futures, options). Given this, the paper treats the bank risk management, focusing on market risk management. In order to determine the correct capital requirements for market risk is taken into account banking book and trading book. Bank managers must know the appropriate tools to accurately assess risk and to take the best decisions in order to increase the bank's income from investments, while maintaining an acceptable level of risk and low cost of attracted resources.

1. The global financial situation
Traditionally, banking and financial institutions have considered that the financial risk is reduced to an efficient management of credit risk. This is not consistent with the current banking system, characterized by complexity and volatility. The risk department of a bank must include a global vision, with all risks that affect the bank, not just credit risk. The financial crisis which started in 2007, has affected the economies first, but starting with Lehman bankruptcy, has been extended to countries in Central and Eastern Europe. Confidence in financial markets fell sharply between the various participants which led to higher risk premiums applied to transactions, and then reflected in prices. Lack of confidence also affected, the mechanism of transfer of liquidity, the cash holding are not interested in placing this liquidity.

In this context the intervention of central banks focused on getting a thawing financial markets by taking measures such as:
- reduced rates of intervention for relaxation of financial policies;
- extended eligibility of the guarantees for loan;
- increased the system liquidity through market operations.

In parallel with the efforts of the central banks, the governments need to take additional measures to cut taxes, increase government investment and stimulate consumption. In a global frame of financial crisis, increasing the taxes should be used sparingly, in certain periods, because this operation can become ineffective if not accompanied by a reform of public spending. In this case, the economic dec rease can be stronger, due to decereasing of consumption and discouraging of the investments.
2. Market Risk Management
A financial institution is confronted with specific risks arising from financial market activities and common risks for all businesses and individuals.

Due to the increasing use of derivative products (swaps, futures, options) in financial markets, market risk management has become increasingly important. Many assets of the banking sector are not liquid, such as loans, which necessitates exposure to market risk to achieve profit. The most significant source of market risk is the volatility of asset prices within trading and investment portfolios. Volatility problems occur not only in new or illiquid markets but also in mature markets.

The factors that cause market risk are:
- systematic and specific market risks;
- primary directional risks and secondary risks;
- volatilities and correlations.

In this context, to obtain realistic estimates of future values of these factors, it is necessary to choose the most appropriate models to describe these uncertainties.

The most important method for managing market risk is the Value at Risk (VaR) technique. Banks must estimate the maximum level of market losses without exceeding a probability greater than 1% on a static portfolio of trading for the next 10 days. This number is then tested (back test) to meet minimum capital requirements for market risk, under Basel II. Capital requirements for market risk are gathered for other types of risk, resulting in minimum regulatory capital requirement MRC [6]. Each bank can choose parameters that best fit their own internal purposes.

It is very important for banks to distinguish between the banking book portfolio and trading book portfolio, in the context of correct determination of capital requirements for market risk. Banking book portfolio refers to all assets of the bank and off-balance sheet positions that are not listed as trading book positions. Trading book portfolio refers to the sum of positions of financial instruments and assets held by the bank for insurance purposes to hedge other elements of the trading book or for trading.

3. Market risk management for banking book portfolio
Market risk management for banking book is managing assets and liabilities, in order to attract new funding in the financial market. The management activity for the banking book is developed in two directions: liquidity management and interest rate management.
For proper management of bank liquidity, one may use such a strategy of gap analysis. 
Gap analysis to achieve all assets and liabilities grouped into two categories:
- assets / liabilities sensitive to changes in market interest rates;
- active / passive insensitive to changes in market interest rates.

It shall draw up a timetable, depending on the time remaining until maturity, which will be distributed based on assets and liabilities. Maturity value will be given the actual balance of that element in that period. A negative liquidity gap means lack of resources related to investments within a period [3]. It also required the bank to prepare a management plan for liquidity crisis.

In the gap analysis will not take into account that part of the assets and liabilities that are indexed to a floating rate, but only those that are indexed at a fixed rate throughout the period. The sensitivity value (assets - liabilities) shows the influence of achievement or failure of a coating when interest rates change by 1% resulting in a surplus not distributed, favoring a gain or an unfunded deficit, which imply a loss.

4. Market risk management for trading book portfolio
Due to the fact that in Romania there are no quotes in the money market, the reference rates published by the NBR (BUBOR, BUBID) and some bonds traded on the interbank market are used to determine the yield curve for RON.

RON exchange rates and foreign currencies exchange rates are determined from the BNR exchange rates quoted by the day reassessment. Forward rates are calculated based on the yield curve, obtained by Reuters collection system yields for public bonds and the coupon 0 exchange rates used in the review. The methods used to evaluate trading positions are:
- *marking to market*, using market prices to determine temporary profit or loss of operation;
- *marking to model*, based on theoretical price (marking to model strategy is used when it can not be used marking to market).

5. Weaknesses of market risk management
Although Basel II regulations were designed to streamline the management and risk control and to ensure appropriate allocation of capital of a bank, actually these regulations implement the provisions of this agreement could not prevent financial crisis from 2007-2008. European banks have started to implement Basel II in 2008 and Japanese banks have already applied the rules of the agreement in 2007. Among the main disadvantages of Basel II regulations include the following:
- occurrence of inadequate provisioning situations following a pro-cyclical evolution of volatile capital;
- inadequate development of internal risk measurement systems due to an inhomogeneous application of Basel II regulations in the world or even within the same financial markets, which lead to different risk weights for identical assets.

Basel Committee for Banking Supervision issued in January 2009 a package of consultative documents to strengthen the original agreement [1].

Table 1: Measures to strengthen the Basel agreements

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<th>Changing the minimum capital requirements</th>
<th>Internal process for adequacy of capital</th>
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<td>• re-securitization processes</td>
<td>• liquidity tests</td>
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<td>• increased capital requirements for securitization exposures</td>
<td>• disclosure of liquidity</td>
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<td>• extending the principles of prudential assessment for banking book</td>
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6. Conclusions
One of the main objectives of the management of bank assets and liabilities is to increase the bank's income from investments, while maintaining an acceptable level of risk and a low cost of attracted resources. Analysis of bank risk-based, should include in addition to quantitative and qualitative factors, such as the effectiveness of internal controls, management quality and accuracy of management information systems. Ability to anticipate and to manage the risks of banking and financial institutions enable them to take advantage of opportunities, to meet customer requirements and produce return for the shareholders, in a financial frame in continous change.

References:

5. Ioan, M., Dumitru, I., ”Managementul activelor și pasivelor bancare”, ASE, 2009
9. Titu, C., ”VaR-o măsură de calculare a expunerii la risc, pentru o bancă, pe piaţa de schimb valutar”, București, ASE, 2004
Supervisory expectations for the credit risk management approach used by individual banks should be commensurate with the scope and sophistication of the bank’s activities. For smaller or less sophisticated banks, supervisors need to determine that the credit risk management approach used is sufficient for their activities and that they have instilled sufficient risk-return discipline in their credit risk management processes. The Committee stipulates in Sections II to VI of the paper, principles for banking supervisory authorities to apply in assessing bank’s credit risk management systems. Principle 6: Banks should have a clearly-established process in place for approving new credits as well as the amendment, renewal and re-financing of existing credits. 4. Credit risk management.