Banking activity Management by
The risk assessment and measurement

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Summary:

Rapid innovations in financial markets and the internationalization of the financial flows have created opportunities for developing some new products and supplying a wider product and service range to the banks .
Liberalization of the financial markets , the severe competition and the diversification of the offered products expose banks to new risks and provocations . This new approach confirms the fact that the banking management generally and the risk management especially represents essential concern for the security and the stability both of each bank and the entire banking system .

Key words:

management , risk , banking market , credit , foreign currency , interest , financial , capital , operational .

The main characteristic of the last decade is the fact that the rapid innovations in financial markets and internationalization of the financial flows have modified the bank sector , making it almost unrecognizable . Both technologic progress and liberalization have offered new opportunities for banks and non-banking institutions, putting increased competitive pressure on these entities .
The growing of the international financial markets and of a wider diversity of the financial instruments allowed banks a greater access for financing . At the same time the markets have expended and came out opportunities of developing new products and providing a wider range of services . Since the rhythm o these changes seems to be faster in some countries comparing to others, the worldwide banks have became generally more engaged in the process of developing the instruments, products, services and technique .
The traditional banking activity - based on making deposits and granting credits – is nowadays only a part of the typical bank activity , being often the least profitable .
The new activities based on information, such as trading in the financial markets and generating of the incomes through commissions , represent major sources of profitability of the banks now .
Liberalization of the financial markets , increased competition and diversification of the offered products expose banks to new risks and challenges , which leads , in order to keep the competitive activity , to the necessity of continuous improvement of the management way of an activity and including risks . Also, a wider targeting of the banks to the market required changes in approaching of the rules and banking supervision . This new approach confirms the fact that the banking management generally and the risk management especially represent essential concerns for the security and the stability both of each bank and the entire banking system .
The credit risk assessment process in a competitive market environment represents a complex process . The guarantee security of the banking financial institution and stability of the financial systems and markets implies , besides management and

banking super-vision also other factors such as sustainable and healthy macroeconomic policies, and a well developed legal framework .
The risk increases exponentially with the rhythm of change [1], this means that most that in the most cases , the market ability to transform itself is greater than its capacity of understanding and appropriate adaptation to the risks involved .
So far, banks have considered activity in credit risk management as their most important task , but considering that the banking environment has become more complex and volatile , it has appeared awareness of need for management exposure to other operational and financial risks . It also must be considered the risk of the activity in cash, process management components of assets and liabilities (liquidity risk, interest rate risk and currency risk) and also market risk and the transactions generated by its own.
Risk management requires, usually crossing of several steps for each type of financial risk. It is necessary to identify and assess exposures to specific risks of each banking activity.

1.Hennie van Greuning, Sonya Brajovic: *Analysis and banking risk management: assessment corporate governance ;* Irecson Publishing House, Bucharest , 2003 , page 16

Also, decisions should be made on acceptable levels of exposure to risk and on basis of methods and tools to cover excessive exposure. It is also required the appointment of responsibilities for different aspects of risk management , and check to comply with designated responsibilities.
Generally, banking risks fit into four categories : *financial, operational, business risks and risk of occurrence of events. Financial* risks , in turn, contain two types of risk. *Pure* risks – including liquidity risk , credit risk and risk of solvency – may result in a loss for the bank if they are not properly managed . *Speculative* risks , based on financial arbitration , may result in a profit if the arbitration is fair or a loss, if the arbitration is unfair.
The main categories of *speculative* risks are interest rate risk, currency risk and price (or position) the market.
Financial risks are also subject to complex interdependencies that can significantly increase the overall risk profile of the bank . For example, a bank engaged in a activity that involves the use of exchanges is normally exposed to the foreign exchange rate, but will be also exposed to liquidity risk and interest rate risk.
Operational risks are associated with the organization and operation of a bank's internal systems , including computer systems and other technologies ; they are associated also with compliance policies and banking procedures and with the measures directed against poor management and fraud .
Business risks are associated with the environment in which a bank work , including macro-economic and policy concern, legal and regulatory factors and also infrastructure and the existing system at the entire financial sector . *The risks of events* include all types of exogenous risks, if they would materialize they could jeopardize the operations of a bank.
Market risk is the risk that a bank to record losses due to adverse fluctuations in market prices. Exposure to such a risk may arise as a result of taking, deliberately, some speculative positions by the bank (trading on own)
Market risk results from changes inn the price of equity instruments, the goods, money and exchange .
Market risk management involves :

- defining the risks that a bank intends to assume ;
- defining of financial authorized instruments ;

- establish control strategies and risk coverage ;
- establish the assumed limits of exposure to risk and monitoring their observing..

The main components of the market risk are:

- afferent risk of position to stocks;
- afferent risk of goods;
- interest rate risk;
- foreign exchange rate.

Stock risk reffers to taking or possessing positions in the register of transaction afferent to stocks and their derivatives(futures, swaps on individual stocks or stock ratios).

Goods risks reffers to possessing or taking some positions to the goods transacted at commodity exchange, futures and other derivatives.

Interest rate risk is defined as being the risk of deterioration of the bank assets situation under the influence of some adverse modifications of the interest level on the market.

Depending on each bank stategy the interest risk can be:

-substantial risk of interest rate-namely net interest margin and the market value assets in stocks presents high fluctuations depending on interest rate modification.

-low risk of interest rate changes that result in a reduced performance of the change of bank interest rates.

The components of interest rate risk are:

-*income risk*, namely the risk of making some losses of income in net interest determined by the fact that changes in interest rates on loans taken are not perfectly synchronized with the loan.

-*investment risk* is the risk of loss in net assets as a result of unexpected changes in interest rate.

Entire banking system faces interest rate risk. When interest rates fluctuate, the income and expenses of a bank changes corresponding with changes of economic value of assets and liabilities. The net effect of these changes is reflected in gross income and bank capital.

Currency risk is the probability that the variation of the exchange rate on market to lead to reduction in net income of a bank by influencing negative margin bank interest rates.

The appearance of currency risk is determined by variations of the national currency exchange rates of a bank compared to other currencies.

When these variations of the exchange rates are bad, it leads to losses for banks.

The phenomenan of relaxation of exchange controls and liberalizing cross-border circulation of capital in recent years led to on exponential growth of international financial markets. In the conditions the volume of global foreign exchange transactions far exceed the volume of international trade and capital flows, contributing to an increased currency risk.

Currency risk is generated by non-correlation between the amount of capital and assets and liabilities stated in foreign currencies or non-correlation between claims and term external debts stated in local currency.

Depending on the meaning evolves exchange rate, foreign exchange rate may give rise to profit or loss, as the bank has a net long or short position in currency. In case of a net long position in currency, the national currency depreciation will give rise to a profit for the bank, and in case of a short currency position, will be a loss for the bank.

The main cause of the domestic currency value fluctuation of a country that creates currency risk arising from changes in interest rates abroad and the country which, in turn, are given by differences in inflation.

These fluctuations are ussually caused by macroeconomic factors and accours on long time periods. These macroeconomic factors that influence the value of national currency are the volume and direction of the country trade and capital flows.
On the value of national currencies operates also short term factors such as political events, expected or unexpected, or speculative currency transactions purposes.
Currency risk exposure of banks lead to different approaches in the sense of serving currency operations of the clients.
These, small banks limit client currency operations only at the sale or purchage of currency an behalf of clients, process in which the open currency positions that create are liquidated in some minutes, limiting the currency risk that the bank is exposed to avery short period of time.
Banks that sustain customer currency transactions and those that maintain correspondent relationships with foreign banks are exposed to a high currency risk. This is because these operations are ussualy performed by medium and large banks.
Earnings or losses depend on the meaning evolves currency exchange rate and the net long or short position which the bank has in that currency.
Currency risk occurs after the execution by the bank of some operations for it clients or in its own name.
Operational risk is the risk of recording losses or the risk of unfulfilment the estimated profits, which is determined by the internal factors (inadequate conduct of internal activities, maintaining an inappropriate personal, etc) or by external factors (economic environment, competitive banking environment, etc)
Each commercial bank, through its own management of operational risks, aims identifying, evaluating, monitoring and adopting measures to decrease losses due to operational risks.
The main categories of operational risks are:
a)*internal fraud* or *attempt of internal fraud*, represents illegal/illicit acts of the employees(directly or in collaboration with third parties), done knowngly and with the intend to cause the bank a loss or to earn unproper sums.
b)*external fraud* or *attempt of external fraud* is illegal/illicit acts of the customers, third parties, directly or in collaboration with third persons, made knowngly and with the intent to cause a loss for the bank
c)Registration of some *bad practices* related to customer by:
-misuse of data on customer;
-operations of money laundering, suspicious transactions, the financing of terorist operations or actions of financial crime, etc.
d)*damage to assets and persons* as a result of events such as: fires, earthquakes, landslides, floods, etc;
e)*off work and malfunctioning of the systems.*
f)*Improperly applied treatment on clients and business counterparts*, and fault data processing related to them:
-wrong, fault recording, processing, administration of customer data by employees.
-wrong transmitting, communication of data in system or outside it.
-making (unintentional) accounting errors, etc.
g)*information security risks, the occurrence of events* such as:
-failure level of classification assigned documents (secret service, strictly confidential, confidential, etc);
-change the level of classification given by the issuing person for the received documents, etc.
Legal risk is a component of the operational risk arising from a failure to apply or wrong application of legal or contractual provisions that affects negatively the bank's operations or situation.

Legal risk components are:

-contractual risk that is followed in the ongoing and closing stage of the contacts and which damages operations and transactions of a bank;

-legislative risk arises in the field of classification in legal regulations as well as in internal.

At the banking company level are elaborated proceedings for forming provisions for litigations, to cover possible losses that would register as a result of jurisdiction of litigations in which the bank has the status of the defendant.

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