TRENDS IN THE EVOLUTION OF THE CREDIT RISK INDICATORS AT BRD-GROUPE SOCIÉTÉ GÉNÉRALE

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1. General Considerations

The risk credit is defined through *the losses suffered by an economical agent due to not collecting the anticipated incomes flow on due term, as a consequence of the deterioration of the financial state of the debtor.* From this perspective, the credit risk has two coordinates: the dimension of the risk and its quality.

The dimension of the risk denotes the measure of the loss suffered by the credit as a consequence of the debtor's impossibility to reimburse the credit, and the amplitude of the risk results both from the possibility that the non-payment takes place and also from the guaranties which can reduce the loss, in case of non-payment. Not paying such a debt is an uncertain event. Starting from these aspects, the credit risk can be divided in three risk[1]: the non-payment risk, the exposure risk and the recuperation risk.

The non-payment risk consists of the probability of not paying a debt on due term. There are certain possible definitions that we can give to the non-payment: not making a payment obligation, the violation of a convention or the economical non-payment.

The economical non-payment takes place when the economic value of the debtor's assets decreases below the value of the remaining debts. If the market value of the assets decreases below the one of the liabilities it is possible that the liquidities flows do not allow the reimbursement of the debt.

The probability of non-payment cannot be directly measured, but the historic statistics of the internal payment of the rating agents or of the central authorities can be used.

The exposure risk. The exposure risk quantifies the uncertainty regarding the collecting of the borrowed amounts. If the credit is reimbursed according to a firm contractual program, the exposure risk can be considered reduced or neglected.

The recovery risk. In case of non-payment, the recoveries are not predictable. They depend on the type of non-payment and on other factors, such as: the debtor's guaranties, the type of these guaranties which can be collateral or of a third party. Not making a payment does not mean that the debtor will never pay, but it leads to the initiation of certain actions, such as the renegotiation or the obligation of reimbursing the remaining amounts.

2. Research Methodology

From the quantitative point of view, the credit risk is measured through the losses registered by the bank and the case of non-payment of the debt. The credit risk results from the combination of the non-payment risk to the exposure risk and the recovery risk. The resulted loss (L) is random and it can be regarded as the product of a random variable characterising the non-payment (D), an uncertain exposure (X) and a rate of the unsure recovery (R): $L = D*X*(1-R)$.

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[1] Greuning, H, Brajovic, B. - Analyzing and Managing Banking Risk a framework for Assessing Corporate Governance and Financial Risk, The World Bank, bilingual edition, Irecson Publishers, 2004;

The non-payment risk or LGD depends on the values assigned to the three basic parameters:
• the probability of the non-payment;
• the exposure;
• the recoveries.

The predicted loss is the result of the loss caused by the non-payment and by the probability of non-payment. LGD is the amount submitted to the risk or to the exposure, except for the recoveries: LGD = exposure - recovery = exposure x (1- recovery rate %).

The predicted loss is the loss caused by the non-payment, and also the risk amplitude: The predicted loss = LGD x probability of non-payment = exposure x (1 - recovery rate (%) x probability of non-payment (%).

In other words, the predicted loss includes through a single measure the three components of risk: the exposure, the probability of non-payment and the recovery. The predicted loss is at the same time a statistical loss, defined as an average parameter. The unforeseen loss is the deviation from an average value, the volatility, and it can be expressed, for instance, by the variations of the non-payment rate.

The qualitative evaluation consists of obtaining the information regarding the financial responsibility of the clients, the establishment of the real goal for which they claim the credit, the identification of the risks the client's activity deals with, depending on the tendencies of evolution of the economic conditions in the future and of estimation of the efforts the client will take for the reimbursement purpose.

The quantitative dimension encountered in the evaluation of the credit risk, refers to the analysis of the client's financial reports and the estimation of the future financial results for determining the client's capacity to reimburse the credit in due time.

It is also necessary the revision of the crediting operations, the integrity and the credibility of the crediting process depending on objective crediting decisions which should assure an acceptable risk level in report to the expected profitability.

The revision must contain a detailed credit analysis, of determination of the price policy and of the crediting limits on different levels of bank management, the guaranties for all types of credit, and also the methods of re-evaluation of the guaranties.

In order to make a correct analysis of the manner in which the quality of the credits limit evolve in time, with an impact on the profitability, the adequacy of the capital and the confidence of the clients in the bank in question, the banks calculate for the estimation of the credit risk the following categories of indicators:

✓ the volume of the overdue loans/total loans x 100: it is preferable that the report tends toward zero;

✓ the volume of the nonperforming loans/total loans x 100: the optimal value is the minimal one because the bad loans charge the financial activity and results of the bank generating content problems of the bank system;

✓ reserves for loan losses/total loans x 100, indicator which expresses the bank management regarding the evolution of the loan portfolio quality;

✓ provisions for loan losses/net losses x 100, indicator which reflects the prudency level adopted by the banks in the crediting policy;

✓ gross profit /provisions for loan losses 100, respectively the cost paid by the bank in as far as the credit risk cover is concerned.

3. Credit Risk Management at BRD-GSG

The universal bank model of BRD – GSG proved its qualities in the context of a highly deteriorated economic environment. Although the bank system suffered in 2009 because of the accentuated growth of the risk cost, the

safe policy of BRD made it stay at a perfectly manageable level.

Further on we propose ourselves to make an analysis of the credit risk the BRD – GSG bank confronts with based on the system of indicators used by the bank. However, before starting the analysis, we believe it is important to make a few theoretical specifications regarding the strategies and methods used by the bank in managing the credit risk.

In this regard, the strategy of implementation of the Basel II Agreement of BRD – GSG bank stipulated the adopting of a standardised method for the credit risk from January 2011.

Regarding the bank risks management ways used by the bank, namely the credit risk, we will succinctly present a few aspects which we consider more important.

According to information in the annual report of the bank, the process of administration of the significant risks is focused on the risk profile analysis, in order to maximise the report between the profit and the risk in the different activities performed within the bank.

The policies and procedures regarding the crediting activity and the credit risk and established and implemented according to the assigned roles and responsibilities so that the following are assured:

- the maintenance of certain healthy crediting standards;
- the monitoring and control of the credit risk;
- the proper evaluation of the new business opportunities;
- the identification and administration of the bad loans.

The entities involved in the crediting activity and in its monitoring assure the administration of the credit risk both on the level of each credit facility, and also in aggregate way, at the level of the entire portfolio, the credit risk nature elements being analysed in correlation to the other risk types with which they are in strong interdependence relation, considering the following main coordinates:

- the concentration of the credit;
- the risks related to the counterparty;
- scoring/rating credit system.

The establishing of certain criteria of granting the healthy and well-defined credits is an essential principle in the crediting activity. The bank has a well-defined approval process, being performed with the observance of the "four eye" principle. The segregation of the functions assure the independence among the personnel responsible for the management of the clients relations, the one that approves the credits and the one that makes the incurring and monitoring of the reimbursements during the life time of the loan. The credit approval process is centralised. On all approval levels the unanimous approval of the members of the committees in question is necessary.

In order to limit the credit risk, the personnel and crediting policies of the bank establish that the personnel involved in the crediting activity has the experience corresponding to the dimension and complexity of the operation it has to perform.

The Risk Division, through the Credits Control Department, carefully monitors the evolution of the loan portfolio. In this regard, the Credits Control Department performs sample based verifications, visits the territorial units and issues recommendations. The bank has implemented early detection analysis of the credits with the indexes of deterioration and management of the problem credits (static and dynamic delinquency analyses).

4. Trends of credit risk indicators at BRD - GSG

Further on, we will make appreciations based on the credit risk indicators calculated at BRD – GSG. We remark from table no. 1 and graphic no. 1

that the analysed indicators have an oscillating trend, high values being registered in 2009 and 2010 on the background of the international financial crisis.

The share of overdue loans in total loans and the nonperforming loans ratio must be as low as possible in order to express an efficient management of the credit risk. This parameter is useful to the risk analyst for establishing the reserves necessary for covering the losses in the loan portfolio.

Table no. 1			*Thousands lei*	
Years	**2007**	**2008**	**2009**	**2010**
Overdue loans	1787596	2726501	4097253	4345438
Total loans	25988188	32887940	33937371	33164000
The share of overdue loans in total loans	**6,878**	**8,290**	**12,072**	**13,102**
Nonperforming loans	66426	994	154331	175447
Total loans	25988188	32887940	33937371	33164000
Nonperforming loans ratio	**0,255**	**0,003**	**0,454**	**0,529**
Reserves for loan loss	1635779	2612979	4056429	4333284
Total loans	25988188	32887940	33937371	33164000
Loan loss reserve ratio	**6,294**	**7,945**	**11,952**	**13,066**

Source: Own calculations based on the information from the bank's annual reports

Graphic no. 1
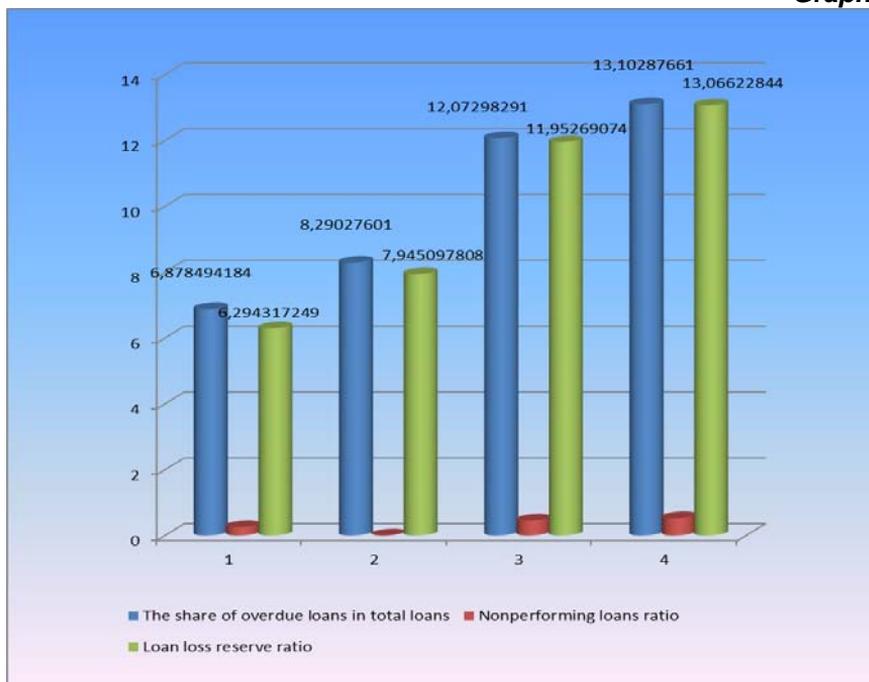
Source: Own calculations based on the information from the bank's annual reports

As for the dynamics of the general reserve fund for covering the losses in the loan portfolio, it expresses the way in which the bank anticipates the evolution of the exposure at the credit risk. If we notice a growth in the reserve fund for the constitution of the provisions, this is due to the predictions elaborated by the bank that the losses in the loan portfolio will be greater.

At the same time, the analysed indicator is most of all an external use indicator, representing an alarm signal for the entire bank system.

From the analysis of the data presented in table no. 1, we observe that the reserve follow an ascendant trend which denotes that the bank has anticipated the growth of the crediting risk.

The evolutions of the provisions seems to follow the same trend, because their value increases in the following years, as it can be observed from table no. 2 and graphic no. 2.

Table no. 2			*Thousands LEI*	
	2007	**2008**	**2009**	**2010**
Provisions for loan losses	763239	953191	1257126	1651414
Net loss	409513	562785	220543	405397
Rate of loan loss provisions	**186,377**	**169,370**	**570,014**	**407,357**
Gross Profit	1215253	1785162	1450390	1228081
Provisions for loan losses	763239	953191	1257126	1651414
Provision coverage ratio of gross profit	**159,223**	**187,282**	**115,373**	**74,365**

Source: Own calculations based on the information from the bank's annual reports

Graphic no. 2
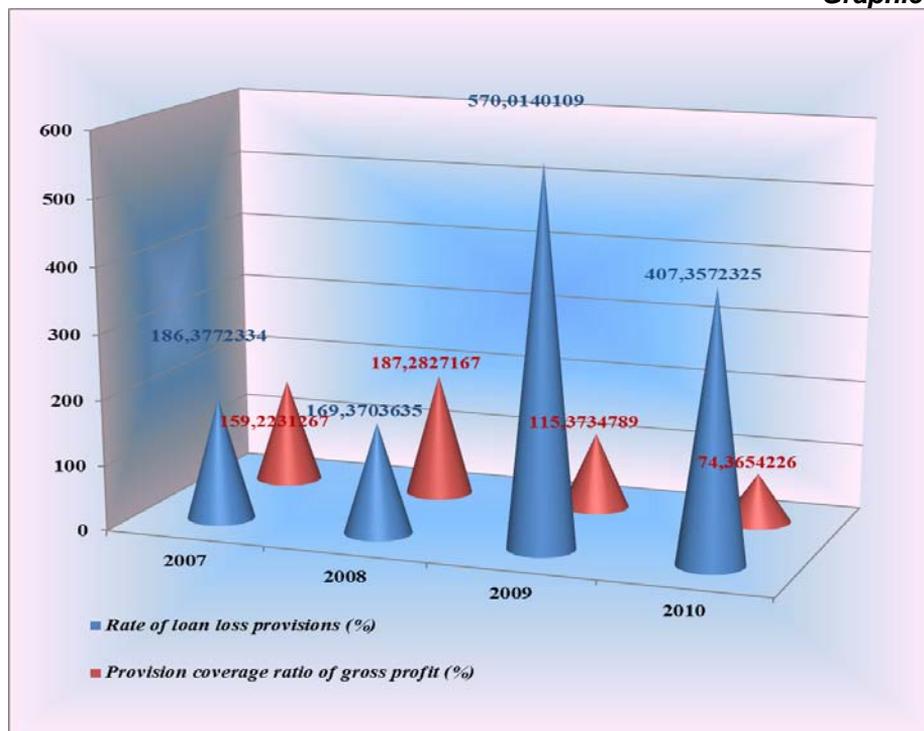
Source: Own calculations based on the information from the bank's annual reports

Structure of bank loan portfolio   is   shown   in   table   no.   3   below:

Table no. 3				Thousands lei
	2007	**2008**	**2009**	**2010**
Loans under surveillance	*1406065*	*2079970*	*2377894*	*2410488*
Substandard loans	*224653*	*431605*	*888477*	*890572*
Doubtful loans	*90452*	*213932*	*676551*	*856777*

Source: Own calculations based on the information from the bank's annual reports

From analysing table no. 3 we remark that the volume of the loans is continually increasing during 2007 – 2010, in 2010 being approximately double as compared to the level of 2007. We observe that the level of the substandard and doubtful loans from the portfolio have increased quite significantly, which emphasises a negative aspect of the crediting activity performed by the bank. In graphic no. 3 we illustrate the above mentioned aspects:

Graphic no. 3
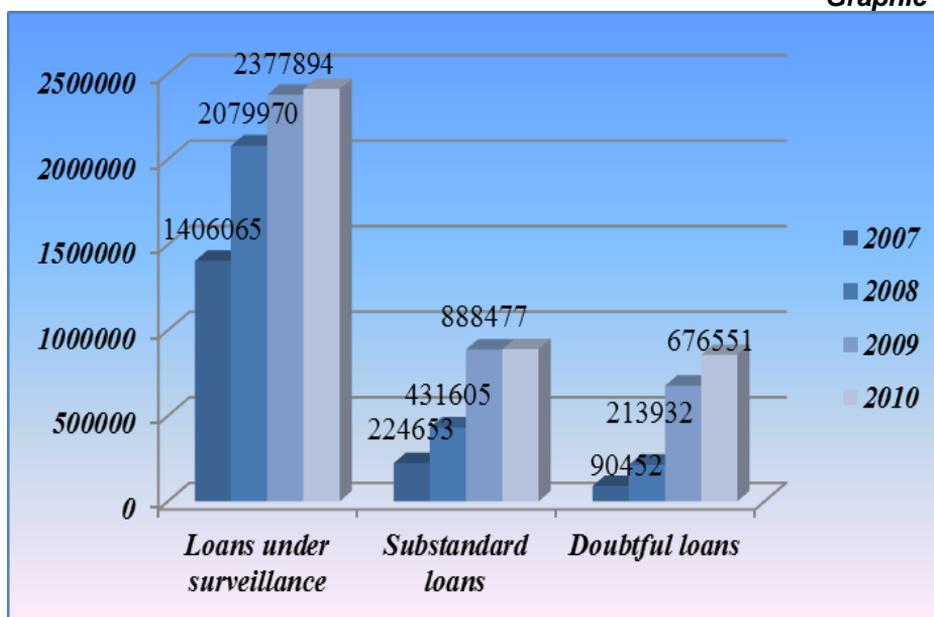
Source: Own calculations based on the information from the bank's annual reports

The dynamics of the assets comparatively to the dynamics of the total credits is an indicator of the credit risk to the extent in which it expresses an accelerated growth both of the assets and of the liabilities. The capacity of a bank to efficiently manage the loan portfolio is limited by the competence of the personnel, by the crediting policy structure, by the resources the bank holds and by the way of their administration. Therefore, an increasingly loan portfolio cannot be efficiently managed in the terms of the conservation of the same resources.

The processing of an increasing volume of information, brings along an increased risk degree, considering that,

in these terms, the probability of error occurrence considerably increases.

From the below graphic representation (table no. 4 and graphic no. 4), results the next evolution of the assets comparatively to the evolution of the credits at BRD – GSG. Thus we remark that at the level of 2007 – 2010 the increase rhythm of assets exceeded or was close to the increase rhythm of credits, but starting from 2009, the increase rhythm of assets was much smaller than the one of credits, on the background of the non-governmental credit expansion.

Table no. 4   *Thousands lei*

	2007	2008	2009	2010
Assets	39982580	50919603	48290508	47494119
Rise %	100	27,35	-5,163227608	-1,649162606
Total gross loans	25988188	32887940	33937371	33164000
Rise %	100	26,54956937	3,190929563	-2,278818238

Source: Own calculations based on the information from the bank's annual reports

Graphic no. 4
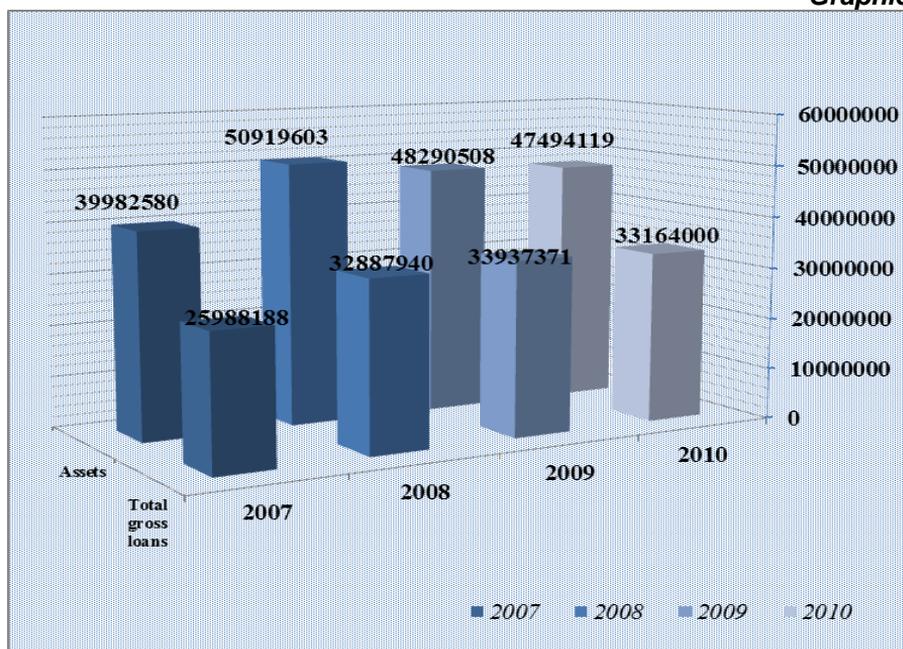
Source: Own calculations based on the information from the bank's annual reports

5. Conclusions

As a conclusion, BRD-GSG has registered on the whole good performances, aspect regarded in the context of the global crisis which shattered the bank systems of all states and which did not went round Romania.

However, we believe that the bank must take more intense efforts to improve its performances, especially as far as the attraction of resources from the clients, the crediting policy and the management of the interest, liquidity and credit risk that we believe to have the most powerful

impact on the financial results of a bank of the size of BRD-GSG.

Therefore, we can state that the bank efficiently manages the credit risk, which is higher only in the crisis year 2010. Still these risks are reduced by the procedures of risk management, implemented in accordance with the Société Générale standards.

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