

## The Evolution of the Non-performing Loans within the Romanian Banking System

Lavinia Maria Nețoiu<sup>1</sup>, Titu Nețoiu<sup>2</sup>, Nela Loredana Meîță<sup>3</sup>

<sup>1,2,3</sup> University of Craiova

lnetoiu@yahoo.com, loredanameita@yahoo.co.uk

**Abstract:** *The context of macroeconomic uncertainty existing on international markets leads to the amplification of a broad spectrum of risks in the current activity of a bank. This article delineates the recent modifications in the domain of credit risk management in banking and highlights the issues of relevant studies, models for credit risk assessment and regulatory framework, on the background "mutations" caused by the international financial crisis.*

**Keywords – loans, crisis, outstanding, performing, caution**

**JEL Classification: G23, G33**

### 1. Introduction

In the present economic context, the relationship bank-client is based on a simple principle of banking conduct: caution. Banks, on one hand, pay more attention in determining the reliability of the client applying for a loan, no matter that he is a natural person client or legal person client and removed from their offers those products of „toxic” credit type; namely „loan for everything or loan only with the identity card”. The clients are much more reserved when it comes about accessing a bank loan or worse, accessing a new bank loan.

*Non-performing loans* are defined as bank loans granted to the clients whose economic-financial situation is getting worse for different reasons, during the credit process, so that the conditions of complete or partial reimbursement of the loan, payment of interests and bank commissions are not assured anymore, according to the provisions of the loan agreement. However practice showed that a loan must be considered as being part of the *non-performing* category when its recovery becomes unsure or impossible for the bank.

When these loans appear, a series of negative effects experienced by the bank, or client appear as well, but also at a macroeconomic level.

These effects are:

- from the bank's point of view: profit decrease; decrease of credit sources that generates profit; commission growth; decrease of personal capital.

- from the client's point of view: turnover decrease; growth of the number of creditors; profit decrease; decrease of personal and floating capital; generating bankruptcy.

- from the macroeconomic point of view: financial gridlocks; perturbations in the branches and sub-branches of the national economy; disorders from the monetary point of view.

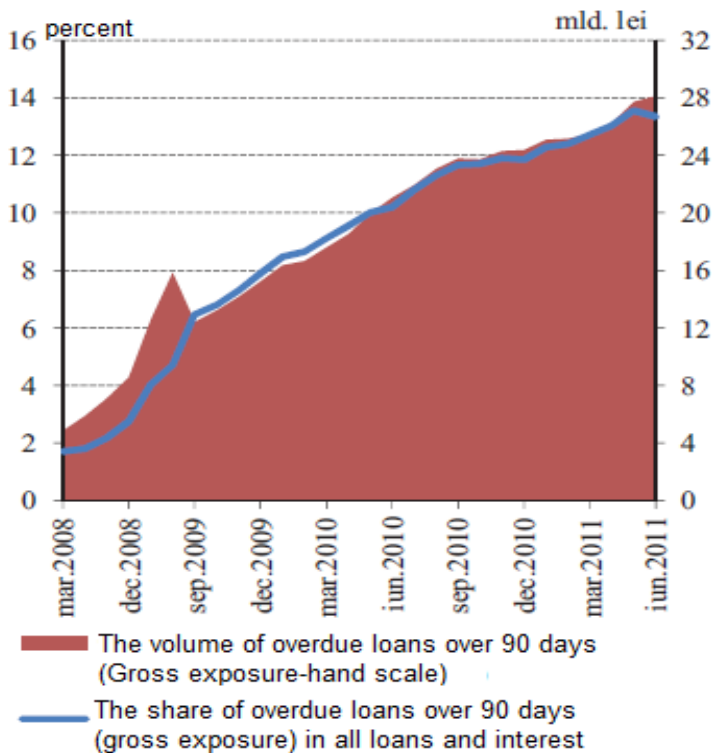
## 2. Realities of the Romanian Banking System in the Problem of the Non-performing Loans

Besides the theory, which is in fact the present reality in Romania?

According to the data showed by the Romanian National Bank, „the credit risk remained the main vulnerability of the banking field”. The instalment of the non-performing loans has reached 13,41% in June 2011, in regard to 11,9% in December 2010 and respectively 7,9% in December 2009. (Report on financial stability 2011, page 7.)

The continuation of economic uncertainties for 2011 and 2012, the constancy of economic crisis went to the growth of loans and residual interests having an inadequate service of duty, over 90 days of delay, in all loans and interests classified to sum up a quota of 13,4%, *therefore, regarding the number of bad debtors- natural persons, their number has reached 720.000 persons .*

Summarizing the previously mentioned data, the evolution of the non-performing loans is showed in the following way:



**Fig.1. The evolution of the non-performing loans**  
 Source: Report on the financial stability 2011, page. 34

According to the data showed by the Romanian National Bank, in January 2012, back payments to loans were of 5,1 milliard euro, in regard to 3,8 milliard euro, a value recorded in January 2011, growth which appeared in spite of the fact that the Romanian economy has had an ascending trend lately. A phenomenon which should not be neglected is also the fact that the growth rhythm of back payments is twice higher than the monthly average since last year.

The installment of the non-performing loans reached 16% of the portfolio value in 2012.

This fact explains the bank caution to giving new loans and at the same time reticence of people on the contraction of new loans. Most of the problems appear in case of the return of the currency loans while the back payments at loans in lei are similar to those from last year.

The cause is the result of the high lending during the economic boom from 2008. The crisis that hit Romania in 2010-2011 made debtors to face a tough reality: low income and instalments that they could not pay. We can state the fact that today back payments are „on fashion”, they have become something usual, therefore, if 2-3 years ago, to have delays concerning instalments was the nightmare of every borrower, meantime, this thing became something natural.

It's the classical case of credit risk, practice explaining with clear examples, what and how this kind of risk is supported by the bank. The causes that led to the appearance of this risk appeared outside the bank– salary reduction, shutting down some production capacities, unemployment growth, undervaluation of Romanian leu but effects were felt clearly in the banking profit. Another type of bank risk outside the bank and which also favored the appearance of non-performing loans is the exchange risk appeared after the increase in the value of Euro but also after the growth of the interest rate percentage, a fact that led to a deterioration of the relationship between the banks and clients, these being unsatisfied with the outstanding debt growth to banks.

There is a series of causes that generate non-performing loans which are exclusively the bank's fault: a wrong analysis of the client's situation; the wrong framing in the group of reliability; the lack of following the loans. Concerning these causes, they can appear in a lot of situations of the relationship bank-client, namely:

- *causes that appear during the stage of analysis of the lending file handed in by the client:*

- too much credibility lent by the bank to its client;
- lack of some information about the client;
- a brief economic-financial analysis of the client;
- personal interest.

- *causes which come from the way of lending, the loans referring to the employment conditions, repayment conditions, underwriting conditions, prosecution and control conditions associated with the granted loan;*

- *causes which appear during the lending process: micro or macroeconomic changes; lack of bank experience in tracing the warning signals;*

The recovery of the non-performing loans doesn't have to represent a main practice but, on the contrary, to be a last applied solution. This stage means risks, time and money.

The simple enumeration of these negative effects of the non-performing loans shows us why banks have to carry on an activity of performing lending. However, the appearance of the non-performing loans in the administration of a bank is not always the banks' fault. The banking practice identified a lot of causes that generate these kinds of loans, causes grouped according to the factors that generate them, namely:

- *causes of macroeconomic order*, which act outside the banking system and which can be of political, economic, market, legislation order, etc;

- *causes generated by the beneficiaries of loans*: defective management of the activity; causes independent of the client's activity; frauds, embezzlements, non-compliance with the provisions of the loan agreement.

In order to recover the non-performing loans the following methods are used: the

recovery of the loans in a friendly way; banking supervision; methods of recovery by the debtor's economic rectification; repo.

The recovery of the loans friendly– represents a method that applies in case of debtors who have an inadequate service of duty for many months and which deals with issuing some letters by the bank through which the debtor is warned on the back payment and also the consequences in case of overdraft of these debits;

The recovery through setting up the banking supervision – has the following courses of action:

- closing the accounts opened at other banks;
- supervision of the provisions and their limitation at strictly necessary;
- liquidation of the redundant stocks of raw materials, materials, finished articles, etc;
- creation of liquidities by a development as fast and efficient as possible of the fixed assets with a low occupancy rate;
- enforceability of the loan contraction of factoring or leasing type.

These proceedings apply in a total collaboration with the debtor society; the results are different, although they are not instant;

*Recovery methods by the debtor's economic rectification*–imply the use of some bank techniques if only they lead to the debtor's economic prosperity so that the payment of the loans and interests can be assured.

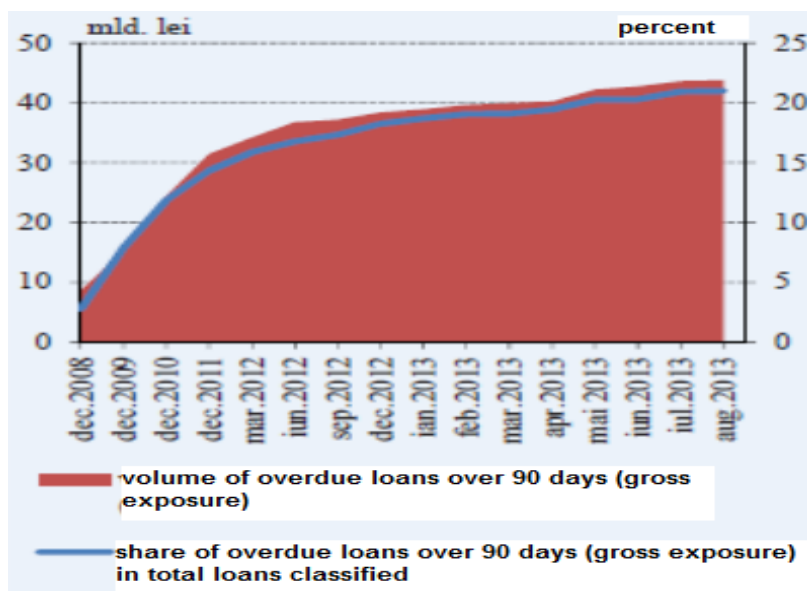
These methods consist of: rescheduling of the loans within the framework of the lending term or over this term; supplementation of the loan by granting a grace period both for loan and interest; recalculation of the loans so that foretokened liquid be enough for the payment of the loan and interest; client debt reduction *with 5% up to 10%, if he proves to be in good faith.*

The repo procedure – is used when all the previously mentioned methods were used, but with no result or when the client doesn't respect the conditions asserted by bank.

At the end of 2012 Romania occupied the unwanted third place among the European countries which recorded non-performing loans. Therefore, although at the beginning of 2012 their balance was estimated at 16% for that year, as was mentioned previously, in December 2012 the balance of the non-performing loans reached 18,2% of the total of the banks' loan portfolios. This non-performing loans represent a reality in 2013 too, in February their balance being of 19% in the total of the loans granted by the banking system annual although dynamics of lending was a decent one, but positive at the end of the year 2012 (1,3%), getting negative beginning with March this year (up -2,6 % in August 2013).

The aggravation process of the loan portfolio quality didn't affect only Romania, but also the neighboring countries (for instance, Slovenia, Hungary, Bulgaria; the highest level of the non-performing debts was reported by Greece, respectively 22,5 % associated with 2012, with 6,5 higher percentage points than the previous year) and, any less, the Western European countries. This situation is the result of an unsustainable growth of the loan portfolios granted during 2003-2008 (period characterized by the relaxation of lending standards) and of the difficulties recorded at an international level in the recovery of the economic growth after the coming out of the financial crisis, as well as legal, judicial, fiscal impediments which hinder the fast resolution of the non-performing debts.

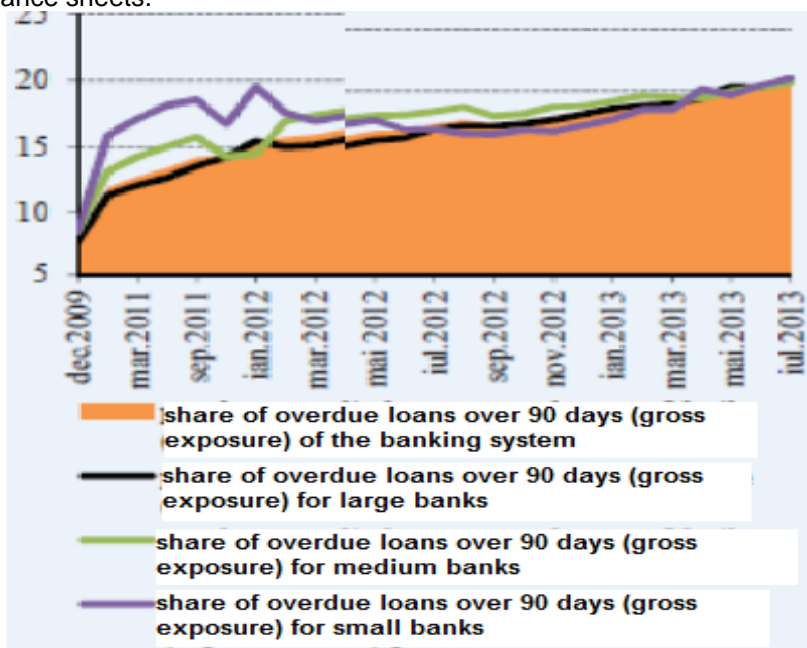
For Romania, as the Romanian National Bank data show, the balance of the non-performing debts (as gross exposure) altogether classified loans and interests continued the ascending course (figure 2.), reaching 18,2 % in December 2012, respectively 21,0 % in August 2013.



**Fig. 2. Non-performing loans at aggregate level**

Source: Report on financial stability in 2013, page 56

At the same time, the analyses performed at the level of Romanian bank groups, determined according to the asset size (Figure 3.) emphasize homogenization tendency in the second term of this year of the loan portfolio quality, mainly in the wake of a faster growth of the non-performing loan amount in portfolios found in the large bank balance sheets.



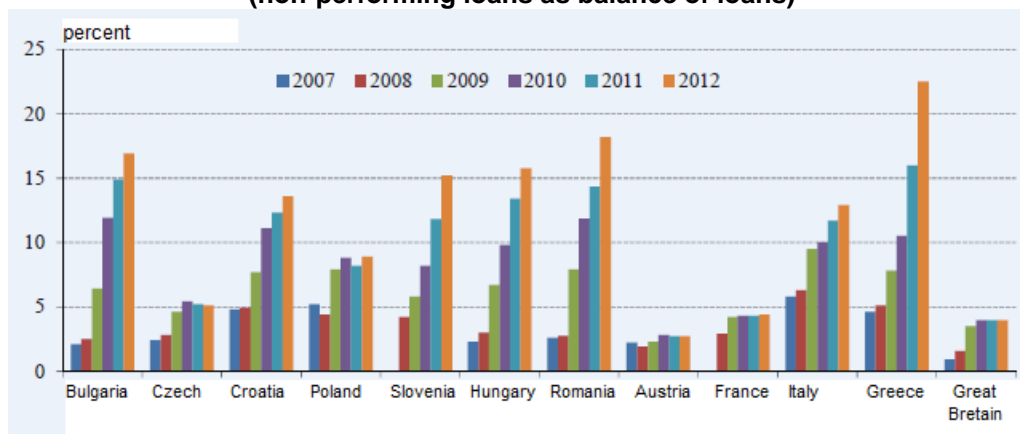
**Fig. 3. – Non-performing loans on bank groups determined according to the asset size**

Source: Report on the financial stability in 2013, page 56

Studies suggest the fact that the existences of a high level of self-correlation in case of non-performing loans, taking into account the fact that an impact in the amount of non-performances will have, most probably, a long-term effect on banking system. Thus, the degradation of the quality of assets from the bank portfolios determines limitation of loan offer, having implicitly a negative impact on the recovery of economic growth.

In this pessimistic tone, we can take comfort in the thought that we are not the only ones who confront this kind of situations. We discover that the neighboring countries record a similar situation as well, according to the data in the chart below:

**Fig. 4. – Loan portfolio quality in some countries from the European Union (non-performing loans as balance of loans)**



Source: Report on financial stability in 2013, page 57

According to the specialty publications (bankingnews.ro, *What losses did banks record because of restructured loans*), the Romanian banking system recorded a loss of 61 million lei in September 2013, along with reclassification of some restructured loans, which determined an addition of commissions of 612 million lei. The good news is that in the first nine months of this year, the banking system won 1,46 milliard lei.

At the level of the Romanian banking system, 20% of GDP one creates debts being in process of insolvency, and nonperformance comes up to 10 milliard euro, so the indicator financial *discipline* has to be accomplished prevalently.

### 3. Conclusions

The decrease of the non-performing loans could be realized by promoting some politics at micro and macroeconomic level that stimulate economic activities and implicitly the lending activity.

Banks apply at present a series of measures intended to reduce the size of the non-performing loans, such as: rescheduling of the loans within the framework of the lending period or over this period of time; supplementation of the loan by granting a grace period both for loan and interest; recalculation of the loans so that foretold liquid be enough for the payment of the loan and interest; client debt reduction with 5% up to 10%, if he proves to be in good faith.

Although the area of the banking activities extended, lending remains another main activity of commercial banks. The main elements that differentiate the loan from

the rest of the banking products are those that the loan represents the main source of income but it has at the same time a high level risk. The lending function is important for both society and country, wherefore it's necessary to appropriate resources adequately and reduction as much as possible of the appearance of non-performing loans.

Credit risk is the most frequent cause of bank failure so that all regulatory environments set standards for its management.

A sound credit risk management is to identify existing and potential risks occurring in any lending activity so that countermeasures credit risk should include explicitly defined policies in this regard.

## **References**

- Căpraru. B. (2010) "Banking - systems, operations and practices", Publishing CH Beck, Bucharest.
- Croitoru. L., (2012) "Monetary policy: unconventional situations", Curtea Veche Publishing House, Bucharest.
- Dardac N., Barbu T.(2009) Coin, ASE Publishing House, Bucharest.
- Nețoiu L., Nețoiu T., Meiță L.(2013) Money and credit, the second, Universitaria Publishing House, Craiova.
- The World bank (2003) "Analysis and Risk Management Banking", IRECSOON Publishing, Bucharest.
- Annual Report of BNR, years 2008-2011.
- Financial Stability Report, years 2008-2012.
- Financial Stability Report 2013.
- BNR Newsletters, years 2008-2013.
- [www.bankingnews.ro](http://www.bankingnews.ro)