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CREDIT RISK MANAGEMENT IN BANKS OF THE REPUBLIC OF MOLDOVA

GESTIUNEA RISCULUI DE CREDIT ÎN BĂNCILE DIN REPUBLICA MOLDOVA

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Rezumat. *Riscul de credit reprezintă riscul actual sau de viitor ce afectează negativ profiturile sau capitalul băncii ca urmare a neîndeplinirii obligațiilor contractuale de către debitor. Acesta este unul dintre principalele riscuri cu care orice bancă comercială se confruntă iar managementul acestuia reprezintă o parte integrată a proceselor decizionale ale băncii. Gestiunea riscului de credit în bănci cuprinde definirea politicii privind managementul riscurilor în conformitate cu strategia băncii, diversificarea portofoliului de credite, stabilirea limitelor privind riscurile întâlnite, respectarea normativelor stabilite de către Banca Națională a Moldovei.*

Scopul cercetării vizează importanța gestiunii riscului de credit și îmbunătățirea acestuia pentru o mai bună performanță a băncilor.

În urma cercetării s-a concluzionat că gestiunea riscului de credit este importantă întrucât reduce pierderile de venituri. Monitorizarea riscului de credit permite băncilor să analizeze într-o mai mare măsură potențialii clienți, astfel reducând posibilul viitor risc.

Cuvinte cheie: risc, credit, management, bancă, administrare.

JEL CLASSIFICATION: E58, F65, G01, G21, H12.

INTRODUCTION

Nowadays, banking sector is the heart of the money circulation in one country's territory. Credits are an important tool in increasing the economy; it allows people, banks and other financial institutions to borrow money and in this way economic transactions can take place efficiently and the economy can grow.

A good credit risk management is important for mitigating the risks that banks are facing, it helps to identify problematic clients and to diminish the losses. Also, it provides better management which leads to the development of the economy.

The purpose of this research paper is to analyze and study the particularities, tools and regulations used in order to minimize credit risk; alongside with the importance and improvement of the management of credit risk in banks.

CONTENT

In order to have a good and comprehensive credit risk management, there are some principles and techniques that the banks in the Republic of Moldova should follow.

There are 5 useful principles for the assessment of banks' management of credit risk. The first principle is resuming at establishing an appropriate credit risk environment, meaning that the management of the bank should implement the credit risk strategy which should be approved and periodically reviewed by the board of directors. The second principle – operating under a second credit granting process implies that banks must operate under well-defined credit-granting criteria and establish credit limits. The third principle – maintaining an appropriate credit administration, measurement and monitoring process implies that banks should implement a system for ongoing administration of the various credit risk-bearing portfolios. The fourth principle – ensuring adequate controls over credit risk implies that banks must ensure that the credit-granting process is being properly controlled and managed. Finally, the fifth principle is about the role of the supervisors.

They should request that banks should have an effective credit risk system which is periodically controlled, measured, monitored and controlled.

Moreover, in order to establish a comprehensive credit risk management system, banks should consider the next important elements when deciding over granting the credit to an individual or entity:

- know your customer: creating a comprehensive customer profile;
- creditworthiness assessment: verify customer's data, e.g. income, credit agreement;
- risk qualification: determining the probability of default, loss given default and risk-adjusted return on capital;
- credit decision: analyzing customers' data in order to understand if the customer will be able to reimburse the credit;
- price calculation: calculating the credit terms for each bank customer;
- monitoring after payout: monitoring how the customers reimburse the credit.

In the Republic of Moldova, the National Bank of Moldova provides necessary regulation for banks for creating a good credit risk management system. Along with the regulations of the NBM, there are regulation of Basel Committee of which all banks in the world follow. The guidelines issued by the Basel Committee encourage banking supervisors globally to promote sound practices for managing credit risk. Although banks may have specific credit risk management practices depending upon the nature and complexity of their credit activities a comprehensive credit risk management policy needs careful evaluation and implementation.

In order to better understand how important a good credit risk management system is, we will further analyze the credit portfolios and bank indicators.

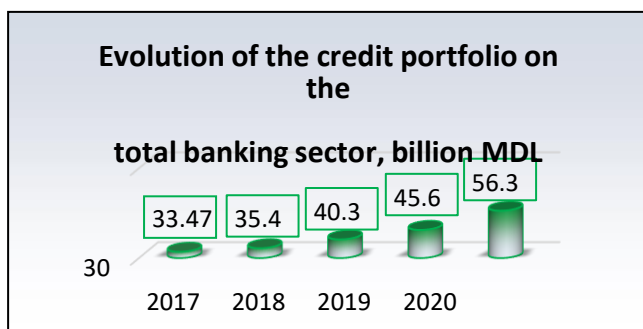


Figure 1. Evolution of the total credit portfolio on the banking sector during 2017-2021

Source: Elaborated by the author based on information provided by the NBM. Available: <<https://www.bnm.md/bdi/pages/reports/drsb/DRSB8.xhtml>>.

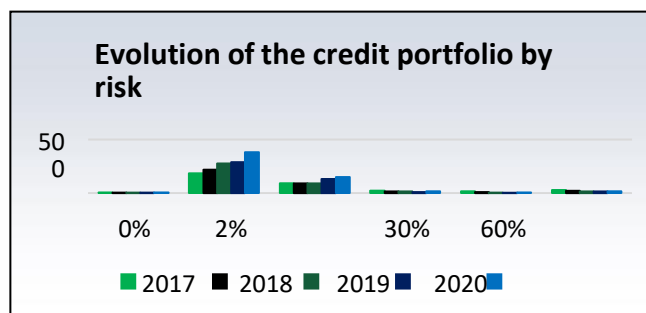


Figure 2. Evolution of the credit portfolio by risk on the total banking sector, during 2017-2021

Source: Elaborated by the author based on information provided by the NBM. Available: <<https://www.bnm.md/bdi/pages/reports/drsb/DRSB12.xhtm>>

In the Figure 1 we can observe the evolution on the total credit portfolio on the banking sector during 2017 and 2021. As we can see in the chart above, comparing with 2017, there is an increase by 68.37% in 2021, which shows the importance that credits have in the banks' assets.

In the Figure 2, we can observe the evolution of credit on the banking sector by risk: (2% - standard, 5% - supervised, 30% - substandard, 60% - doubtful, 100% - compromised). As we can see in the graph, the most part is taken by the standard credits and supervised ones, which means that the bad credits are decreasing and that the banks have established a comprehensive credit risk management system.

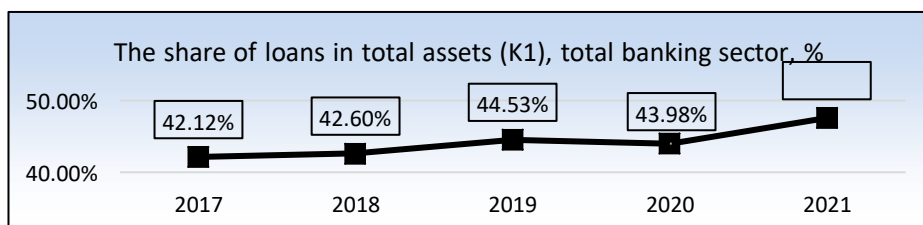


Figure 3. The share of loans in the total assets (K1), total banking sector, during 2017-2021

Source: Elaborated by the author based on the information provided by the NBM. Available: <<https://www.bnm.md/bdi/pages/reports/drsb/DRSB5.xhtml>>

In the Figure 3 we can observe how the bank indicator K1 changed during 2017-2021. K1 indicator is influenced by the volume of loans granted and by the total assets. According to the figure the smallest percent was recorded in 2017 – 42.12%, and in 2021 it increased by 5.43%, recording a value of 47.55%, showing the fact that the loan portfolio increased on the total banking sector. The increase of K1 indicator is due to the evolution of loans in the same period, because they are linked to each other.

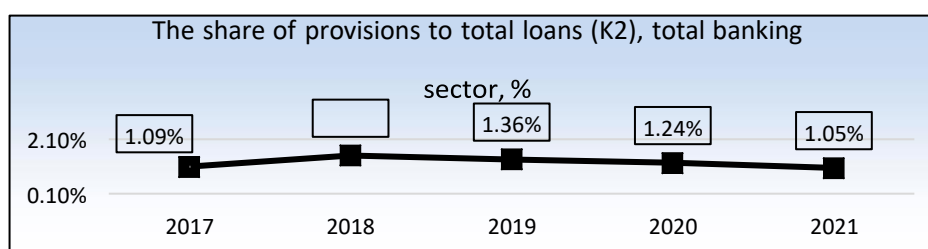


Figure 4. The share of provisions in the total loans (K2), total banking sector, during 2017-2021

Source: Elaborated by the author based on the information provided by the NBM.
Available: <<https://www.bnm.md/bdi/pages/reports/drsb/DRSB5.xhtml>>.

In the Figure 4 we can observe the evolution of K2 indicator, which represents the share of provisions to the total loans of the banks. This is a great indicator which shows us the measure of the management of assets and liabilities of the bank. At the beginning of the analyzed period, K1 measured 1.09%, increasing by 0.41% in 2018 and decreasing since then. In 2021, K2 measured 1.05%. The decrease in the K2 has been caused by the decision of the bank management and how they decide on the creation of provisions.

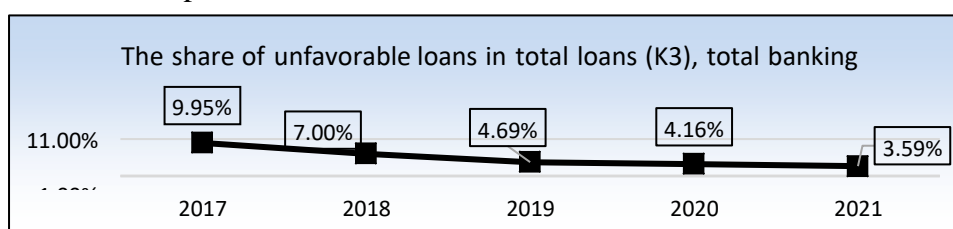


Figure 5. The share of unfavorable loans in the total loans (K3), total banking sector, during 2017-2021

Source: Elaborated by the author based on the information provided by the NBM.
Available: <<https://www.bnm.md/bdi/pages/reports/drsb/DRSB12.xhtml>>

In the Figure 5, the evolution of the unfavorable loans in the total loans, we observe a decrease by 6.36% in 2021, comparing with 2017, which shows us the fact the unfavorable loans have decreased and total loans have increased during the analyzed period and that the system of credit risk management was implemented correctly. Also, the progress made in reducing the volume of unfavorable loans was due to measures taken by the management of the bank to develop and implement new strategies in order to make the banking sector more profitable.

The best credit risk management system is conducted after some steps which will provide banks a more comprehensive information and analysis:

- identify credit risk: involves taking account of vulnerabilities and various types of risks;
- measuring credit risk: careful examination of macroeconomic factors, rates, risks;
- monitoring credit risk: monitoring the condition of individual and entities credits;
- controlling credit risk: involves putting in place predetermined credit ceilings to assist the authorities in banks to take prompt action if the credit limits are exceeded.

Furthermore, due to the fact that credit risk is inevitable nowadays for banks, in order to create the best credit risk monitoring system, banks should find the best ways in which they can reduce the credit risk. Two of the best credit risk mitigation techniques are:

- credit risk protection and mitigation, which implies reduction in exposure, in probability of

default, in loss given default and in maturity;

- credit risk transfer, which involves the transfer of the credit risk.

Risks are an inevitable part of banking operations, but that doesn't mean they can't be mitigated. Commercial banks and private lenders are constantly taking efforts to reduce the risk of fraud and cybersecurity threats to protect the financial information of their clients. When a borrower misses a monthly payment, or worse, defaults on a loan altogether, the lending party is at a loss. That's why it's incredibly important for banks to carefully evaluate each borrower's credit risk, their own reserves and environmental factors before signing off on a loan.

One of the banks' priorities in the Republic of Moldova is to increase their granted credits and to increase their assets as well. In order to do so they should improve their credit risk management process.

CONCLUSION

Through effective credit risk management banks are able to greatly improve overall performance and secure a competitive advantage and they also allow banks planning strategies ahead to avoid a negative outcome;

After analyzing the credit risk management process we would recommend the next procedures for the improving the credit risk management process for banks in the Republic of Moldova:

- close monitoring of commercial loan portfolio: visualizing the information in charts and pictures about customers' data, about loans granted, risks, in order to understand better where they have a problem;
- have a regular update of customers' report and key financial data: This will allow banks to build better client relationships by having a better understanding of the clients' current state of affairs;
- review and monitor the agreement terms: Covenants, agreement terms, if effectively monitored, it can provide lenders with an early warning of loan deterioration.

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