

## **OPERATIONAL RISK DISCLOSURE IN ROMANIAN COMMERCIAL BANKS**

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**Abstract:** *This paper aims to assess the actual operational risk disclosure in Romanian banks. Therefore we focus on the operational risk information that Romanian banks reveal and if they conform to the requirements of the National Bank of Romania. The study methodology consists in testing the annual financial reports for Romanian commercial banks. The analysis shows that the financial reports of Romanian banks are not in consonance with the requirements of the National Bank of Romania relating to operational risk revelation and also there are many discrepancies between Romanian banks relating to the format of the financial report, which presents the operational risk disclosures. Commercial banks in Romania have different approaches of showing the disclosures of operational risk. Accordingly, they do not disclose the same types of information. Our study advises Romanian commercial banks to increase prevailing operational risk disclosure proceedings. The contribution of this paper is to highlight the Romanian commercial approaches of the operational risk disclosures.*

**Keywords:** *operational risk; transparency, commercial banks, Basel II; The National Bank of Romania*

### **INTRODUCTION**

Compulsory disclosure is an important utensil designed to be used by the shareholders and clients to appraise operational risk. Therefore the annual financial reports of the banks should show the key indicators of operational risk, because one of the essential responsibilities that banks have to accomplish is to evaluate and administer the risks that emerge from their business activities.

In this study we scrutinize the quantity and quality of operational risk measurements and governance data that it is presently given by Romanian banks' annual financial reports and establish if the results are in consonance with the transparency requirements of operational risk settled by The National Bank of Romania and Basel Committee on Banking Supervision.

The importance of this research consists in showing of the real situation concerning the disclosure of operational risk in Romanian commercial banks. This paper highlights that the financial reports of the Romanian commercial banks should encompass information about the concept of operational risk, the management procedures, the operational risk capital and the models used to measure this capital. Moreover, we embolden Romanian banking system to disclose the data regarding operational risk because this information is useful to all participants on the market. If they have this kind of details they will have an unambiguous picture of the performance and the manner of dealing with bank risks.

The purpose of this paper is to assess the actual operational risk disclosure in Romanian banks. Therefore we focus on the operational risk information that Romanian banks reveal and if they conform to the requirements of the National Bank of Romania.

## **PREVIOUS STUDY**

Whereas operational risk is increasingly present in the media due to big losses generated by the operational risk events a significant number of academic researchers are interested in this important issue.

Helbok and Wagner, 2005, show an investigation of operational risk disclosure practice for the period 1998-2001. In this interval the operational risk exposure was not imperative, but there was an increasing concern about this type of risk. Their results illustrate that companies with a lower equity-ratio and with reduced incomes prefer a higher level of operational risk exposure. These institutions choose to disclose this type of information for promoting themselves and to ensure the participant on the market that the operational risk is properly administered.

Brown, et al., 2008, research the level of operational risk transparency using SEC requirement and a file Form ADV. The paper highlights that leverage and ownership structures indicate that the shareholders and lenders seem not to have this kind of data or consider it irrelevant. This investigation suggests that regulators should consider to disclosure of more pieces of information because this type of data represent a "marginal benefit to different investments clientele".

Ojo, 2010, aims to highlight the role and the importance of data in strengthening the "financial contagion". Moreover she emphasizes the significance of higher transparency requirements. She considers that this type of information is decisive in helping the regulators in determining the potential sources risk events. The study concludes that disclosure needs to be encouraged because fragmentary or partial pieces of information is on the origin of market failure and the publishing of exhaustive data would reduce the risks caused by maintaining reduced capital level rewards to banks that have a poor management system.

Haija and Hayek, 2012, study the items of operational risk that are disclosed by Jordanian commercial banks and if they abide by the requirements of central bank of Jordan. They test the annual financial reports for 12 Jordanian commercial banks. They show that Jordanian banks adhere to the requirements of the central bank of Jordan, referring to operational risk transparency, but there are not content with the way the commercial banks organize their information in their annual reports. Therefore, they advice Jordanian banks to improve their manner of publishing the information they disclose and to enhance an official structure established by the regulators in presenting the operational risk disclosure.

## **RESEARCH DESIGN**

### *Research Factors*

We will use a model created by Haija and Hayek. This model includes the following three variables:

*First point Definition issues, which includes: operational risk definitions; operational risk measurement system; information on key risk indicators; technology and system risk; risk of human error; legal risk and other operational risk.*

*Hierarchical issues, which includes: risk management framework; establishing operational risk committee; operational risk management department.*

*Regulatory issues include: operational capital charge as % of minimum regulatory capital; operational risk exposure (by business line, if available) unexpected loss from operational risk.*

### Sample Selection

The present research consists of all Romanian commercial banks. Therefore the study population consists in all 41 Romanian commercial banks. Table 1, Table 2 and Table 3 show the disclosure items for all Romanian commercial banks and if they adhere to our analysis factors.

### Data Analyses and Results

**Table 1. The disclosure items in Romanian Commercial Banks**

Disclosure items	Risk Management Framework	Operational risk definition	Establishing operational risk Committee	Policies, processes and procedures	Operational Management Department	Operational risk capital charge as % of minimum regulatory capital	Operational risk exposure (by business line)	Operational risk measurement systems
ALPHA BANK ROMANIA	√	√	√	√	√	√	-	-
ATE BANK Romania	-	√	√	√	-	√	-	√
Banca Comercială CARPATICA	-	√	√	-	-	√	-	√
Banca Comercială FEROTIARA	-	-	-	-	-	-	-	-
Banca Comercială Intesa Sanpaolo România	-	√	-	√	√	-	√	√
Banca Comercială Română (BCR)	-	-	√	√	√	-	-	√
BCR Banca pentru Locuințe	-	-	-	-	-	-	-	-
Banca de Export-Import a României EXIMBANK	-	-	-	√	-	√	√	√
Banca Millennium	-	-	-	-	-	-	-	-
Banca Românească Membra a Grupului National Bank of Greece	-	-	-	√	-	-	-	√
Banca Transilvania	-	√	-	√	-	-	-	-

BANCPPOST	√	√	√	-	√	-	-	-
BANK LEUMI	-	-	-	-	-	-	-	-
ROMANIA								
BRD - Groupe Société Générale	√	√	-	√	-	√	-	√
CEC Bank	-	√	-	√	-	-	-	-
Credit Agricole Bank Romania	-	-	-	-	-	-	-	-
CREDIT EUROPE BANK (Romania)	-	-	-	-	-	-	-	-
GARANTI BANK	-	√	-	-	-	-	-	√
LIBRA BANK	-	√	√	-	-	√	-	-
MARFIN BANK (ROMANIA)	-	-	-	-	-	-	-	-
MKB	-	-	-	-	-	-	-	-
ROMEXTERRA Bank								
OTP BANK	√	√	-	√	√	-	-	-
ROMANIA								
PIRAEUS BANK	-	√	-	√	-	-	√	√
ROMANIA								
PORSCHE BANK	-	√	-	√	-	-	-	-
ROMANIA								
ProCredit Bank	-	-	√	-	-	-	-	-
Raiffeisen Bank	-	-	-	-	-	-	-	-
Raiffeisen Banca pentru Locuințe	-	-	-	-	-	-	-	-
RBS BANK (ROMANIA)	-	-	-	-	-	-	-	-
Romanian International Bank								
UniCredit Țiriac Bank	√	√	-	√	√	-	√	√
VOLKSBANK	-	√	-	√	√	-	-	-
ROMANIA								
Anglo-Romanian Bank Limited	-	-	-	-	-	-	-	-
Banca Italo Romena	-	-	-	-	-	-	-	-
Bank of Cyprus	-	-	-	-	-	-	-	-
BLOM Bank France S.A.	-	-	-	-	-	-	-	-
CAIXABANK S.A.	-	-	-	-	-	-	-	-
Citibank Europe	-	-	-	-	-	-	-	-
FINICREDITO-INSTITUICAO FINANCEIRA DE CREDITO S.A.	-	-	-	-	-	-	-	-
Fortis Bank SA/NV	-	-	-	-	-	-	-	-
ING Bank N.V., Amsterdam	-	-	-	-	-	-	-	-
TBI BANK EAD Sofia	-	-	-	-	-	-	-	-

**Table 2. The disclosure items in Romanian Commercial Banks**

Disclousure items	Information on the models used to manage measure operational risk	Information on Key risk indicators (KRI)	Unexpecte d loss from operationa l risk	Tehnolog y and system risk	Risk of Human Error	Legal risk & other operationa l risk
ALPHA BANK ROMANIA	√	-	-	-	-	-
ATE BANK Romania	√	ATE BANK Romania	-	√	√	-
Banca Comercială CARPATICA	-	-	-	-	-	-
Banca Comercială FEROTIARA	-	-	-	-	-	-
Banca Comercială Intesa Sanpaolo România	√	-	-	-	-	-
Banca Comercială Română (BCR)	√	√	√	√	√	√
BCR Banca pentru Locuințe	-	-	-	-	-	-
Banca de Export-Import a României EXIMBANK	√	-	√	√	√	√
Banca Millennium	-	-	-	-	-	-
Banca Românească - Membra a Grupului National Bank of Greece	√	-	-	√	√	-
Banca Transilvania BANCPOST	-	-	-	-	-	-
BANK LEUMI ROMANIA	√	-	-	-	-	-
BRD - Groupe Société Générale	-	√	-	-	-	-
CEC Bank	√	-	-	√	√	√
Credit Agricole Bank Romania	-	-	-	-	-	-
CREDIT EUROPE BANK (Romania)	-	-	-	-	-	-
GARANTI BANK	√	√	-	-	-	-
LIBRA BANK	√	-	√	-	-	-
MARFIN BANK (ROMANIA)	-	-	-	-	-	-
MKB	-	-	-	-	-	-
ROMEXTERRA Bank	-	-	-	-	-	-
OTP BANK ROMANIA	-	-	-	√	√	-
PIRAEUS BANK ROMANIA	√	-	-	-	-	-
PORSCHE BANK ROMANIA	√	-	-	-	-	√

ProCredit Bank	√	-	-	-	-	√
Raiffeisen Bank	-	-	-	-	-	-
Raiffeisen Banca pentru Locuințe	-	-	-	-	-	-
RBS BANK (ROMANIA)	-	-	-	-	-	-
Romanian International Bank	-	-	-	-	-	-
UniCredit Țiriac Bank	√	-	-	√	√	√
VOLKSBANK ROMANIA	√	-	-	-	-	-
Anglo-Romanian Bank Limited	-	-	-	-	-	-
Banca Italo Romena	-	-	-	-	-	-
Bank of Cyprus	-	-	-	-	-	-
BLOM Bank France S.A.	-	-	-	-	-	-
CAIXABANK S.A.	-	-	-	-	-	-
Citibank Europe	-	-	-	-	-	-
FINICREDITO-INSTITUICAO FINANCEIRA DE CREDITO S.A.	-	-	-	-	-	-
Fortis Bank SA/NV	-	-	-	-	-	-
ING Bank N.V., Amsterdam	-	-	-	-	-	-
TBI BANK EAD Sofia	-	-	-	-	-	-

Table 3. Summary

Disclosure Item	% percentage
Risk Management Framework	12.19%
Operational risk definition	34.15%
Establishing operational risk Committee	14.63%
Policies, process and procedures	34.15%
Operational Management Departement	17.07%
Operational risk capital charge as % of minimum regulatory capital	14.63%
Operational risk exposure (by business line)	9.76%
Operational risk measurement systems	24.39%
Information on the models used to manage and measure operational risk	36.59%
Information on Key risk indicators (KRI)	7.32%
Unexpected loss from operational risk	7.32%
Tehnology and system risk	19.51%
Risk of Human Error	19.51%
Legal risk & other operational risk	14.63%

% percentage: equal the existence of item in banks divided on total number of banks

The previous three tables show the results of our research on Romanian commercial banks.

First of all, by analyzing Romanian commercial banks annual financial reports, we present data that prove that the extent and content of the disclosure of banks on operational risk are not good, emphasizing that managers of the bank, supervisors and other agents are not interested in disclosing operational risk information.

Second of all, we found evidence that most of Romanian commercial banks do not meet the requirements of National Bank of Romania referring to operational risk disclosure: 51.21 percent do not give any information on operational risk. Moreover, only 36.59% give information about the models they use to measure and manage operational risk, 34.15 choose to disclose the definition of operational risk and policies, procedures and processes they use. Furthermore, the preponderance of the banks do not expose information on key risk indicators, unexpected loss from operational risk and operational risk exposure (by business line).

Third of all, Romanian commercial banks do not show the information about operational risk in the same manner. Therefore it is quite difficult to find the information you need about operational risk.

## **CONCLUSIONS AND RECOMMENDATIONS**

We examine the disclosure of operational risk in Romanian commercial banks using the model created by Haija and Hayek. We found evidence that the majority of Romanian commercial banks do not disclose important information on operational risk. Therefore we recommend that National Bank of Romania and supervisors should put a pressure on Romanian Commercial Banks to disclose qualitative and quantitative data on operational risk.

Every Romanian commercial bank should have an effective system in place to identify measure, monitor and control operational risk as a part of overall approach to risk management. Moreover, Romanian commercial banks should give information on operational risk in the same manner in their financial annual report.

One of the limits of this paper is the research method used. We consider that in our future investigations we should use an econometric model that will illustrate the correlation between operational risk disclosure, the size of operational risk capital and the performance of the banks. Moreover, we take into account to obtain data about operational risk capital before the disclosure. Further, we want to extend our sample selection to banks from European Union to have a broader perspective.

Operational risk disclosure is a very important subject because the more information participants on the market know, the fewer the financial crashes will be.

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