STRATEGIES FOR THE MANAGEMENT OF THE BANK'S ASSETS AND LIABILITIES

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ABSTRACT: This paper attempts to present the concept of the optimization of the banking activity through an adequate management that focuses on the correlation between the bank's assets and liabilities and through a superior valorization of the resources employed by the bank by means of active profit-oriented operations. The premise of my undertaking is that the overall success of the banking activity depends on the efficient and detailed correlation of the bank's existent assets and liabilities. Along with its approach to commercial banks, this paper is also concerned with the activity of the business banks, which – unlike commercial banks – operate upon the firms' balance sheets, directly intervening in various financial markets for their or their customers' accounts, in this way also administrating the patrimony of private entities.

Key words: Assets, Business, Correlation, Interest, Liabilities, Optimization, Management

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Introduction

The management of banking institutions is primarily concerned with the integration of the strategic policies meant to maximize the income resulted from the credit portfolio of investments and to minimize the costs of the various categories of earned resources. According to many of the specialists in the field, the management of a bank's assets and liabilities represents, in the final analysis, the management of the risk of the interest rate, given that the majority of a bank's assets and liabilities can be assessed at different levels of the interest rate. This statement relies on the notion of the NII - Net Interest Income, which represents the difference between the income obtained from the interest received from loans and investments, and the interest paid for the attracted resources:

NII = total income from interest paid to the bank – total expenses paid for the interest (1)

Because this indicator is not universal (used by all financial institutions), an alternative indicator has been elaborated. This indicator is expressed in percentages and is designated by the concept of NIM - Net Interest Margin:

Net Interest Margin (NIM) = NII / The Bank's Average Loans Rate (2)

The NIM indicator can also be calculated as the difference between the interest income generated by banks or other financial institutions and the amount of interest paid out to their lenders, in a specific time interval.

The fundamental functions of the Net Interest Margin are:

- to cover the expenses incurred with the maintainance and functioning of the bank,

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- to cover the risk in the loan activity and to earn an adequate profit as a result of the performed activities. Generally, the Net Interest Margins of the commercial banks in Romania ranges between 10 - 15%. These figures are affected by the rate of inflation.

Passive and Active Operations of Commercial Banks

1. Balance-sheet Operations

The passive operations of the commercial bank refer to those operations regarding the constitution of resources, manifested in the following posts:

-The bank's deposits;

-Loans from the Central Bank;

-Loans taken from the monetary and the interbank market;

-The bank's capital.

The bank's deposits are the key financial resource for the majority of the commercial banks and have the following forms:

-Demand or sight deposits;

-Time or term deposits.

a) Demand or sight deposits – refer to those deposits which can be withdrawn at any time, without any notice or penalty. They are characterized by their elasticity. For this reason, banks must be cautious when placing such resources into risky actives.

b)Time or term deposits – represent the most important resource for the bank's liabilities. These are based on contracts with stipulation between the two partners. They have a predetermined maturity date, penalizations being imposed in the case of withdrawals prior to the due date.

The loans from the Central Bank refer to refinancing loans. Commercial banks apply for refinancing to the Central Bank for at least two reasons:

-In order to ensure the necessary liquidity with a view to the exigible debts;

-In order to optimize the structure of their bill portfolios.

These are manifested in the assets (the active) of the commercial banks and have the following posts:

-Cash + minimum required reserves;

-Bills;

-Credits;

-Corporal immobilizations.

The first and the last posts are generally not profit-generating; even though the minimum required reserves are remunerated, the remuneration occurs at a rate that is smaller than that of the market. Despite this, their constitution is obligatory for at least two reasons:

• In order to ensure the neccesary liquidity with a view to the obligations from the passive that have become exigible (the first post);

• In order to ensure the well-functioning of the bank.

The other two mentioned posts are important for the profit and, ultimately, for the solidity of the bank.

As a bank's profits come primarily from the acquisition/purchasing of bills, on the one hand, and the distribution/granting of loans, on the other, these activities have the greatest importance as concerns the active operations.

The structure of the bill portfolio includes:

-The Document of Title (this generates variable income in the form of dividends);

-Acknowledgment of a Debt/ Debit Titles (these generate income in the form of interest).

The latter are government/public or private short, medium, or long-term bills.

In general, the size of a bank's bill portfolio depends on three main factors:

-The size of the remaining resources after covering the liquidity needs and the loan requests of the economic agents;

-The volume of the required bills that serve as guarantees;

-The relative rentability of the placement in bills.

In the banking practice, there are a number of potential constitutive modalities for these portfolios, such as:

-The discount of the bills of exchange;

-The lending of the bills against securities (emitted by the state of by private entities);

-The pension;

-The direct acquisition of bills through subscriptions\auctions directly from the stock exchange.

Out of the total of a bank's active operations, the loans provided to economic agents have – as a general rule – the greatest weight (just as the deposits represent the most important part of the total of the passives). Thus, loans are the fundamental modality of placement of a bank's resources. The extraordinary importance of this activity derives from the role that credits play as the fundamental income source of a bank, as well as from the fact that loans represent the main mode of covering the needs and financial difficulties of the economic agents.

As far as the orientation of the placement is concerned - especially as regards the first three posts, the banks have complete freedom of decision. They are nevertheless required to take into account the market conditions. Important in this respect is the fact that banks are confronted with the risk-profit alternative (risk and profit being the essential components of the banking performance). In other words, the bank must both satisfy the liquidity requirements that ensure due payments and to gain the highest possible profits. The banking placements are not homogenous from this point of view, because:

-cash placements and the minimum reserves have the highest degree of liquidity – thus, the lowest risk as well as the lowest profit for them;

-the investments in the bill portfolio have a medium degree of liquidity and, thus, a medium risk and a medium profit;

-the placement in credits has a low degree of liquidity, involves the greatest risk, but ensures the highest profit.

Every bank needs to constantly optimize the mentioned structure of the assets. This optimization presupposes two possibilities for the banks:

- selecting the assets with a view to the confrontation between profitability and risk;
- diversifying the portfolio.

The selection of the assets within every post and within the three post-groups must take into account the market risk (along with the degree of liquidity and the risk of non-payment). The market risk results from the modifications that occur at the cost of the resources and the credits, and from the modifications in the evolution of the interest rate (presently, a variable rate), respectively.

The diversification of the portfolio must have two major goals: the minimization of the risks and the eventual increase of the profit. At the same time, the diversification of the portfolio must be subordinated to the principle of risk dispersion. Risk dispersion can ultimately lead to the aplatization of the results and to the possibilty of reaching a convenient risk-level. Therefore, the choice of the method of the resource placement and of the credit distribution belongs to each bank, exclusively.

2. Off Balance Sheet Operations

Off balance sheet operations do not contribute to the increase of a bank's resources and do not affect its active balancing, but they do generate profits ... as well as risks.

Examples of off balance sheet operations are:

- Non-credit business – these are the most numerous type of operations; in this case, banks operate in their name and in the name of the customers;
- Payment and debt procedure operations;
- Bill sales and bill purchase for the bank's customers;
- Mandate operations – realized in the name of the bank but on the accounts of the customers; these operations generally refer to the management of the bill portfolio;
- The management of the firms' treasuries, including the activities of financial information services and of financial data processing;
- The purchasing of banking and management-accounting software;
- Ensuring services carried out at the homes of the customers.

3. The Management of the Asset-Liability Matching

The optimization of the banking activity through asset-liability matching requires a superior valorization of the resources employed by the bank in active, profit-generating activities. The success of the entire banking activity is intimately related to an efficient and detailed matching of the existing assets and liabilities.The correlation must, therefore, occur at two levels:

- at the level of the time required for the mobilization, employment, and use of resources;
- at the level of the costs of the credit.

The time required for the mobilization and employment of resources is tightly connected with the bank's liquidity position and becomes a tool/means of operation for the avoidance of the liquidity risk. The asset-liquidity matching, as well as the matching of the resources with the placements, must take into account the time required for employing and for meeting the due dates for debts. As a result, a bank must ensure a balance not only as far as the balance sheet on the whole is concerned, but also as concerns every segment of maturation, in order for it to have adequate liquidity conditions. In the banking practice, several indices (indicators) are used for the assessment of the level of liquidity:

-The liquidity indicator;
-The liquidity position;
-The liquidity rate.

At the level of the costs of the credit – the level of the interest rates represents an important criterium of matching the active and the passive operations of a bank. In the case of commercial banks – which act as financial intermediaries –, functionality and profit depend on the difference between the interest earned from the placement of resources and that paid out for the purpose of attracting those resources. As it is well-known, until the 1980s the interest rate was fixed. This state of afairs presented no problems to the banking management: under these circumstances, banks had the possibility to anticipate with relative accuracy their income and expenses, and, implicitly, also their profits. The variable interest rates that have been introduced afterwards, however, affect both the cost/price of the resources attracted by the banks, and the level of the interest rates applied by the banks to the different categories of loans provided to economic agents. In this case, the concepts of assets, liabilities, and of the sensitive interest that are influenced by the fluctuations of the interest rate in the market have been introduced into the banking practice and theory. Even though not all assets and liabilities are equally sensitive to the variable interest rate, these new elements have made the banking management, in general, and the management of a bank's assets and liabilities, in particular, much more complex. For this reason, the banking practice and theory has adopted a series of specific indicators, such as:

- The rate of the liquidity level;
- The rate of the gap/breach coverage;
- The equation of the banking income and expenses.

4. The Business Banks

The differences among the various types of business banks consist in the distinctive character of the financial markets in the countries in which they operate and in the specific nature of the operations that they perform. Thus, unlike the commercial banks, business banks operate upon the balance sheets of the firms, intervening in the different financial markets for their or their customers' accounts, as well as managing the private patrimony. The activities of the business banks fall into three major categories:

a) Operations with financial bills;

b) Operations that are common with those of the commercial banks;

c) Operations of financial engineering.

a) Operations with financial bills – firstly, business banks organize the emission of financial bills for banks, firms, central and local administrations, etc. In this way, business banks ensure the placement of these bills on the primary market, supervise their secondary market, and maintain the market rate. In order to fulfill these tasks, the banks must be able to correctly analyze the financial state of affairs and to predict the market rate, as well as have knowledge with regard to the financial market.

Secondly, business banks purchase the shares of both capitalized and non-capitalized firms. The acquisition of these financial bills has a triple purpose:

- The constitution of shares portfolios in order to obtain profits in the medum and long run;
- Operations of structuring and restructuring of firms through fusions and absorptions;
- The successful trade with financial bills (shares and bonds), in order to earn profits.

Thirdly, business banks deal with public sale and purchase of firms offers, and with the consultance and financial assistance of potential investors.

Fourthly, business banks ensure the conservation and management of financial bills in the following modes:

-interest rates, dividends, the use of preferential rights;

-free distribution of shares, guarantee of the financial bills custody, etc.

Lastly, investment banks could function as brokers for specific financial bills, in the case of the firms or even of the state.

b) Operations that are common with those of the commercial banks

-The attraction of resources and the constitution of deposits;

-The placement of these resources, especially through the distribution of credits to the economic agents;

-Payments towards the account owners.

Related to the mentioned operations are a number of specific activities, such as:

- Attracting monetary disponibilities through bill offers, products and deposit conditions that are advantageous from the point of view of remuneration, liquidity, divisibility, security;
- Providing loans for different time-intervals;
- Ensuring the effective circulation of the crediting means and instruments;
- Secure storing of values;
- Enhancing and diversifying the offer of financial services for the customers.

Some of these activities generate active and passive balance sheet operations, while others generate off balance sheet operations in a permanent and diversified range.

In some countries, business banks only have activities that are common with those of the commercial banks, namely the collection and granting of loans. Firms are generally preferred by business banks, as these re-sell financial engineering services.

c) Financial engineering operations – these activities include:

-The financing of complex projects – this activity supports – through direct or indirect instruments – the financing of plurianual projects that frequently have an international charcater (e.g., The Eurotunnel);

-Balance sheet operations – restructure the firms. In this sense, business banks provide long-term loans for restructuring to specific firms or take over these firms' investment stocks, re-introducing into the stock-market the financial bills emitted by the latter;

-Fusions and acquisitions – represent the most important financial engineering operation. Business banks primarily intervene in the finding of the firms that are susceptible of being sold or purchased by another that aiming for an external increase. Subsequently, business banks intervene in the selling or purchasing mandate for the negotiations and the juridic requirements for the cession of the debts. Lastly, business banks intervene in the realization of complex projects.

The two components of the acqusition operations are: the fixed component and the variable component. The fixed component is concerned with the remuneration of the investment bank notwithstanding the result of the action, whereas the variable component becomes valid only in the case of successful action and is proportional with the amount of the realized transaction. Before the 1980s, the operation of fusions and acquisitions designated the undertaking of a firm's control package by another. As this activity became more complex, however, a specific concept has been adopted for this – support buying – which means the purchasing of one firm by another using borrowed funds.

Conclusions

The optimization of the contemporary banking activity through the adequate asset-liability matching requires, as already mentioned, a superior valorization of the resources mobilized by the bank for the employment of specific active, profit-generating operations. The optimization of the management of a bank's assets depends on the supervision and management of the bank's placements, which must be directed towards increased security. Thus, a minimum risk – matched to the predicted profit – must solve the problem of a bank's liquidity.

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