

## ALL ABOUT BANKS

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Bank management, banking

Budapest, 2018

Print edition: Hungarian Banking Association

E-book: Foundation for the Development  
of Financial Culture



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No book on banking has been published in Hungarian at least for a decade. The readership of earlier editions consisted mainly of university students majoring in finance.

The recently published book differs from its predecessors. It is principally targeted at practicing bankers in order to clarify a lot of concepts and procedures which they may only know from hearsay. At the same time, in addition to information on banking, the aspects of bank management play an important role in the surprisingly homogeneous book edited from the writings of several experts. By reading it and having an insight into the technical details, we get a comprehensive picture of modern banking, a whole range of new terms, developments and risks.

Over the past decade, not only new financial products entailing new pricing techniques, hidden, striking or even frightening risks appeared in the market, but **the information revolution completely rewrote the operation of the banks and the whole banking system, as well.** Today, the meaning of telephone is completely different from its meaning in 1930. Nowadays, banks are completely different from banks in 1930, but the situation has considerably changed since the recent financial crisis, as well. Of course, today's mobile phones can also be used for calling, and bank balance sheets still have the assets on the left side and the liabilities on the other side. However, there is a huge difference: you can get acquainted with your phone step by step, even while using it. At the same time, the operation of an institution which manages the money of a lot of people has to be thoroughly understood. It is not enough if only the senior managers are familiar with the

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organisation, the tasks, opportunities and risks. Bank management is a big challenge for everyone. You should relearn it and brush up your knowledge from time to time. This recently published book helps you in this effort.

**Community bank, agile organisation, risk appetite, digital bank, charge back, restructuring paradox, open banking...** are only some selected topics the readers of this small-print 370-page book can learn about.

The length is justified by the fact that according to the preface, the editors aim to give a practical, modern comprehensive handbook in Hungarian language into the hands of colleagues, students studying in financial higher education or the clients of banks who are interested in the topic.

At the request of the Presidency of the Hungarian Banking Association, in order to achieve this goal, editors *Levente Kovács* and *Erika Marsi* commissioned a wide range of practicing bankers, advisors and university teachers to be their co-authors or contribute to the book as proof-readers or reviewers.

The book may evoke the interest of different groups of readers.

**Novice bankers, university students and clients** interested in the mysteries of the banking profession can receive comprehensive information about the entire operation of banks.

**Experienced bankers** might find the accurate, all-inclusive descriptions about novelties interesting in the first place. It may be useful to learn details about banking activities they are less familiar with, thus having a better understanding of the relationships between their own work and other professional fields. In addition, there might be descriptions and findings which might provide a new aspect and inspire experienced bankers to come up with new solutions even in familiar topics.

The first chapter reviews the types of banks, touching on online banks and community banks, mentioning **shadow banks**, as well. The description of the framework of banking regulation introduces the aspects of regulation and provides an overall picture of **the Basel Committee** and **the European Union's banking regulation**. In the part about internal management and organisational structure, the authors deal with the **agile organisation**, organisational units called to existence by the requirements of digitalisation and business ethics. The chapter gives us a clear overview of the **bank' lines of defence**. The development of a bank's strategy is determined by the differences between the business models of banks and production companies. The terms *vision*, *mission* and different *strategies* (risk, capital, portfolio and product strategies) are also explained. The most exciting part of the chapter gives us an insight into questions related to digitalisation, the big challenge.

The second chapter entitled “**Risk management and the quantification of risks**”, which is the longest part of the book, reflects the regulatory and methodological development which risk management in banking has undergone over the past decades. After reviewing the major risk types and the risk management organisation, the authors introduce the readers into strategic risk management, the definition of risk appetite and issues of capital management. The understanding of the **regulation of the capital requirement, capital buffers** and capital planning is facilitated by illustrative pictures and examples. In addition to the definition of the term, the chapter about **credit risk** deals with forecasting expected and unexpected loss, as well as with **credit rating systems**.

After providing definitions, the subchapter about **market risk** describes the monitoring and *limit systems*, illustrating them with a *market risk dashboard*. Subsequently, the sources and measurement methods of banking-book interest-rate risk are introduced.

In order to enable a better understanding of **operational risk**, the subchapter on operational risk compares this risk type with the characteristics of credit and market risks, throwing light on the differences and mentioning the main methods of operational risk management and the risk types specified by the supervisory authority (legal risk, conduct risk, reputational risk, model risk, information risk and communication risk).

As for other risks, *liquidity risk, strategic risk, concentration risk, model risk* and *residual risk* are also explained. The chapter also includes a *methodological appendix*, which provides a deeper, more detailed insight into topics such as *scoring systems* the estimation of risk parameters and the possible methods of market risk measurement.

In the chapter on **lending activity**, among other topics, we can read about guarantees and *covenants* (commitments), the pricing of loans and the *rating of claims*. After the comprehensive presentation of the lending process, the authors describe corporate lending products. Regarding the process of corporate lending, they deal with the responsibilities of the business side and tasks related to risk analysis, mentioning that banks apply different practices of task sharing between *sales managers, analysts* and *risk managers*. The readers can also learn about the characteristics of *project finance*, SME and agricultural lending from this chapter. Loan products to retail clients and the lending process are also presented, and, regarding the products, the authors give us an insight into the details of the *credit card business*. A separate subchapter is devoted to consumer protection in retail lending. We can get an overview of the administration of standard loan products. The fourth chapter introduces the methods used for **claim management** by corporate and retail loans. We can understand the process of the selection of claim

management methodology, learn what restructuring paradox means, when it is worth throwing good money after bad and the moral risk we have to face.

The fifth chapter deals with **fundraising** and **investment service**. In addition to presenting the deposit and the securities issued by **credit institutions** (bonds, certificates of deposit, mortgage debentures), it also describes characteristics of money market funds and the structural trends of bank financing. We can compare standard retail investment services with *premium* and *private banking* activities. In practice, different models exist for the management of private banking activity, ranging from a separate division to private banking activity integrated into the retail, investment or corporate divisions. According to the authors, **confidential asset management**, the new area of private banking, has huge potential.

Chapter 6 focuses on **treasury** and *asset-liability management*. It explains why it is important to deal with the coordination of assets and liabilities, how the **banking book** and the **trading book** can be separated, what should be considered when calculating liquidity position and what the direct instruments of *liquidity management* are. By means of internal settlement price or **transfer price** management, the liquidity and position risks taken by business areas can be centralised in field responsible for asset-liability management. We can read about the components of the *transfer price* and the *total business price*. Based on examples applied by banks, asset-liability management can be organisationally independent or a separate unit within the organisation of the treasury. The main responsibilities of the Treasury organisation include providing financing, the *operative management* of the risks generated by the operation of the bank and the trading book risks, *trading, sales* and *commission* activity. We are given an insight into the work of the trading desks (**FX, MM, fixed income**) and the sales desk, the main transaction types. We can also learn what it means when the price is “hit”. The chapter provides an overview of the benchmark and reference interest rates, methods of their setting and their characteristics.

Chapter 7 is about **cash flow, payments** and **bank account management**. The authors introduce the main payment methods, their features, the EU-level and the Hungarian *legislation* on payments, as well as the rules of multilateral interbank payment facilities. A separate subchapter is dedicated to the *bank card*, which represents two lines of business in banking: the issue and acceptance of cards. Most banks join the **four-participant business model**, in which the different banks, which are in clearing relationship with each other, are responsible for the aforementioned two lines of business. The **interchange fee**, which is paid by the acquiring bank to the issuing bank upon purchasing transactions, is a special element of the business model of the card infrastructure and aims to ensure balanced interest between the two participants in banking. We can find information about the revenues, expenditures and costs related to the business lines of card is-

sue and card acceptance. We can learn when the amount is charged back (**charge-back**) to the acquiring bank. In addition to the expansion of the disposal channels on a bank account (netbank, mobile bank, video bank etc.), the banks shall provide access to the data of the payment account for so-called third party service providers through an open API (application programming interface), however, only with the prior consent of the clients (*open banking*). Certainly, some readers will be glad to find out the meanings of the terms **nostro** and **loro**.

Chapter 8 deals with the bank-specific core activities of banks. The **area of accounting & finance** is responsible for issuing the bank's financial statements, based on which the public, the supervisory authorities and investors can judge the compliance of the bank's operation. As far as the responsibilities of **controlling** are concerned, the authors give a more detailed description of planning, the *division of profits and losses* for measuring and assessing performances, as well as the two methods of *transfer pricing*. The **compliance organisation** has to be separate and independent. Its responsibilities belong to the categories of *risk assessment*, *support* (counselling, education) and *monitoring*. The authors share information about the aspects to be considered during product development in connection with **product and sales management**, the necessity of simplifying the product portfolio, the characteristics of sales channels and the aspects of the establishment of the multichannel model with the readers. Due to the increasing number of projects apart from BAU (Business As Usual), the majority of larger banks operate a **project management office** as an independent organisational unit, which is responsible for high-priority strategic projects and the optimal implementation of all projects within the bank. The future role of **bank information technology** is very well expressed by the following statement: "*In the future, not the financial institution with the best IT network will be the market leader, but rather the digital company providing the best financial services.*" The subchapter introduces the current structure of bank information technology in a way that is also understandable for users, including those changes which are expected in the area of systems or organisational structure. Out of the five main areas of bank security interpreted in a complex way, I would like to mention information security and business continuity management. In relation to the latter, the difference between the **disaster recovery plan** and the **business continuity plan** is apparent. In addition to the description of the functions of the legal area, it is useful to clarify the separation of legal, compliance and data protection tasks.

The functions of the **internal auditing organization** are detailed in Chapter 9. We learn that the activity of internal auditing consists of two separable scopes of duties: the activity that gives certainty and the internal counselling activity. At least 70% of the total resources of internal auditing organization have to be spent on the former. The internal auditing organization has to be independent of the

areas to be audited, the management of the institution and its governing body. It has to carry out its activity, select its methods and make statements and proposals independently of any external influence. We can find out how the **risk-based internal auditing organization** works, what this means during its strategic and annual planning activities, in the course of conducting audits and tracking measures. The findings of the audit can be considered to be the most important part of the internal auditor's work, related to which the chapter contains specific pieces of advice. In order to ensure high-level work, a quality assurance process has to be operated and the knowledge of the employees shall be developed.

The language of the book is clear and understandable. In spite of the fact that the book was written by several experts, the style of the chapters and the depth of the elaboration of the topic can be considered as homogenous, which contributes to understanding and significantly enhances the reading experience. A lot of clear pictures and examples facilitate better understanding. In the last chapter, the list of abbreviations is very useful, as it includes the English and Hungarian meanings of the abbreviations of frequently used terms and phrases.

The book is the result of the work of several experts, who contributed to its publication by writing, making comments, giving advice, proofreading and, last but not least, with careful and critical editing. The professional standard of the book, the diversity of the presented banking solutions and the description the challenges the banking industry faces reflect their knowledge and practical experience.

The authors reached their goal: the specialist book provides an extensive summary of the current knowledge of the sector. It should be an essential reference book in the library of each serious institution.