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THE REACTIVE PROBLEM LOANS MANAGEMENT IN UKRAINIAN BANK

In article the usefulness of a systematic approach to the management of problem loans in the bank. It was determined that the control system problem loans in the bank – its structural and functional integrity of the object, the subject, the principles and mechanism. Bits and pieces of the effective interaction management problem loans will minimize losses in the event of the bank's bad debts. The article described the strategy settlement debt of the bank.

Keywords: problem loan management, problem loans, the subjects of management, strategy settlement of problem debts.

Problem statement. While forming and developing monetary policy for 2014 - 2015 banking institutions in Ukraine should first of all take into account the fact that it will be implemented in an unfavourable environment, that is orchestrated by global recession and is very unpredictable. Uncertainty in financial and commodities markets will generate significant variation in economic performance of Ukraine. Unfavourable macroeconomic situation may lead to deterioration in the financial conditions of borrowers and thus possible increase in bad debts. As such, there is an objective need for improved management of problem loans in the bank.

Review of recent research and publications on the topic. The problem of bad debts control in banking system is actively investigated in the context of financing and credit risk control management. Specific issues of problem loan management in banks were discussed in the works of V. Danilishyn, V. Kloba, V. Mishchenko.

Remaining part of the problem. Despite the fact that domestic and foreign scholars made significant progress on the topic it should be noted that many issues related to the theoretical principles and practical aspects of problem loan management in banks (object definitions and business management principles formation, the factors that should be considered in system formation management, methodology) are not disclosed.

The study is a synthesis of theoretical approaches and practical experience to form a system of reactive problem loan management in banks, that can effectively function in times of economic instability and is capable for further development and improvement.

The main results of the study. We suppose that problem loan management system in banks should be based systematic approach, the application of which will improve the decision making process and optimize the organizational structure. The most important characteristics of any system are its structure (elements structure and relationships between them) and functions (the ability of the entity to perform actions to achieve the goal).

As such, we believe that the problem loans management system – is a structural and functional integrity of related elements (objects, subjects, principles and mechanisms), whose interaction minimizes losses or risks with the borrower.

The object of managerial influence is a credit exposures position, which we propose to understand as the risk of potential bank losses in relationship with the borrower that will not be able meet obligations under the influence and by the interaction of external and internal factors.

Above discussed definitions allow us to formulate the purpose of problem loans management system, which we see in minimizing potential losses in the bank's relationship with the borrower-risk carrier. In the most general terms, it is determined by the amount of funds provided by the borrower, and the probability of default (probability of default of the borrower).

The system of problem loan management in banks should be based on a number of principles that we propose to split between general (inherent to any management system) and specific.

The structure of the general principles includes:

- Integrity – reviewing all elements as a complex system;
- Openness – required consideration of the system relationship with other bank management systems and the external environment;
- Complexity – need to consider the complexity of problem loans management system by controlling large number of factors affecting the credit risk position of the bank, including relationship between them and their possible consequences;
- The system of problem loan management in banks ability to integrate new elements, if required by the need to achieve management objectives;
- Performance. Management system should provide the possibility of reducing NPLs and / or increase the ability of the bank to minimize the negative consequences of their occurrence;
- Flexibility and adaptability, is the ability of the system of problem loan management in banks to adapt to the changing internal and external environments and high speed of response to them;
- Adequacy, i.e., results corresponds to current market environment;
- Efficiency, i.e. the ability to overcome the negative consequences of the emergence of bad loans with a minimum amount of necessary resources (financial, human, time, material);
- Versatility and universality – system ability to regulate and control the credit risk positions on a permanent basis, despite the impact of external and internal environments;
- Hierarchy – providing such a multilevel structure of decision-making on credit risk positions, ensuring adequate distribution of powers and responsibilities.

The above-discussed principles are general, universal. However the system of problem loan management in banks has certain specifics related to the characteristics of the object, purpose and methods of management, which leads to the need to observe the following principles:

- Responsibility control for accepted credit decisions and quality of its service;
- Centralization of management in specialized units that should determine how the strategy works with credit exposures and take full responsibility for the results of its implementation;
- Awareness, which implies that the control subjects fully aware of the characteristics of credit risk's position;
- Ensuring equality of opportunities and actual procedural steps for borrowers, regardless of their financial capabilities;
- Uniform standards of work with troubled loans;
- Reasonable risk sharing between banks, borrowers and specialized commercial organizations that service distressed debt;
- Use of modern methods for problem loans management;
- Specialization for realization of certain features for problem loans management system by including internal units of the Bank and specialized commercial organizations.

Abilities and instruments to control external factors are very limited, but by acting in timely manner bank can mitigate their impact and avoid significant losses. Primary focus should be given to factors related to the borrower and the collateral. As only they ultimately determine the credit risk profile of the bank and its' credit risk positions. The main tool to prevent the negative impact of these factors group is an effective monetary policy.

While forming the system of problem loan management in banks internal factors should be treated in the first role as they can be managed and controlled.

Internal factors that are primarily related to the characteristics of credit risk position are loan product parameters. They affect the rate of defaults and losses in the distribution of credit exposures. Both in times of crisis, and with the growth of the market, optimal bank loan products are essential in terms of prevention occurrence of problem loans. This effect exists for both the borrower (the parameters of loan products to meet its needs and capabilities) and the bank (the parameters of the loan meet Banks' opportunities). It is worth noting that the range of credit products, that are prime for the bank, as well as products, unwanted and banned for sale, defined by credit policy.

An in-depth study require internal factors that are not directly related to the characteristics of credit risk positions, but ones that determine the credit risk profile of the bank and the possibility of bad debts. We suggest consolidating these factors into three groups.

The first defines the objectives of monetary policy that are aligned to objectives of the bank. In case of an incorrect set of the policy the level of strategic risk increases. In our opinion, that was one of the causes of the banking crisis in Ukraine. The most important strategic failures of banks in the pre-crisis period was unjustified growth in loans («credit boom») and the development of new market niches, especially mortgage lending. As a result, this led to a significant increase in bad debts in 2009-2010.

The second group of internal factors in the bank determines the available resources (financial, material, labor, information) and technologies for achieving these goals, including the ability of management to effectively use them.

To prevent the occurrence of problem's loans it is important to determine whether the bank has enough resources to achieve the objectives set out in its credit policy. Some of the elements of resources are defined by an ability of rapid transformation over time and may be subject to monetary policy purposes (eg, introduction of innovative technologies, the appropriate training of credit managers). The other elements of the resources have limited opportunity for transformations over time due to market constraints, lack of financial resources and

other reasons (eg, to increase its share capital, a significant increase in logistics). Therefore, objectives of monetary policy and its implementation mechanism should take into account resource constraints while building internal capacity of the bank, which will prevent the emergence of problem loans.

In research proves that significant number of banks in Ukraine before the crisis developed and implemented the credit policy, without having sufficient amount of resources. The biggest divergence in resources, in our opinion, was observed in:

- Financial resources: banks developed mortgages without having proper maturity profile of resources that in turn brought to a shortage of liquidity;

- Workforce: banks offer borrowers more complex credit products, the risks were not properly investigated. In the absence of a sufficient number of qualified personnel for the development of risk assessment models for complex credit products, banks are exposed to additional risks.

The third group includes methodological support (regulations, procedures, process cards, etc.) credit process, credit risk management, and problem loans management approved by the relevant authorities of the bank. That should be based on the principles of corporate governance and is consistent with its practical implementation. Qualitative methodological support will minimize the level of operational risk, which can also lead to the emergence of bad loans.

Thus, we determined that the formation SPLMB must consider many external and internal factors that arise during the planning phase of the credit, the formation of resourcing and finally opening and maintaining credit risk positions.

An integral part of any system, including SPLMB are functions among which, we suggest to attribute, is planning (the formation of monetary policy), regulation (management tool to compare actual performance of credit risk position versus the planned and develop measures to address them), analysis (study of credit risk positions and evaluation of their sensitivity to changes in external and internal factors) and control (supervision, inspection and comparison of characteristics of the actual credit risk positions versus planned).

As noted above, preventing the proliferation of bad loans in the bank requires the introduction of evidence-based monetary policy, the purpose of which is to control credit risk in the process to ensure the most efficient allocation of credit resources to obtain the maximum possible income from lending operations.

Credit policy should identify the following approaches used in lending and, in the case of effective implementation will prevent the emergence of bad loans: the creation and implementation of qualitative and quantitative credit risk assessment. Standardization of loan products by establishing clear procedures and methods of analysis of potential borrowers to reduce the cost of credit services and improve customer service. Flexible credit terms, depending on the type of credit product (program, individual, complex). Complex credit risk management that is carried by respective departments within their powers on all stages, whether application is pending or under support. Controlling proper funds usage by the borrower.

On the basis of developed monetary policy and its' requirements, a preventive problem loans management system is employed on an ongoing basis and includes:

- monitoring of risk positions for signs that may indicate the occurrence of problem loans. In order to systematize these signs the following matrix of problem loans is presented.
- diagnosis of the borrowers' ability to repay and determination on the basis of diagnosis the characteristics of exposure (standard credit loan, pre-bad loan stage; loan with clear signs of problems).

If loan is detected to be with severe symptoms of problematic nature, it activates reactive management, which involves the introduction of measures to control bad debts.

The main method of recovery of bad loans is its restructuring (changing the initial conditions of the contract) with the failure of the debtor to meet its' obligations. In an agreement of restructuring the following elements might be introduced: restructuring provision, restructuring payment schedule (extension of

credit, grace periods) Restructuring charges for loan (loan schemes change from the classic to the annuity, reduced interest rate) conversion of loan and interest, write-off fines and penalties and so on.

The decision on restructuring must be substantiated and adopted in the same manner as the decision to grant credit.

In our opinion, restructuring is not the most effective method to restore credit, because its central goal is to give the borrower an opportunity to restore the financial situation, which is short-term.

This method is effective when the problems of the borrower are temporary and are not systematic. Also its worth noting that in domestic banking practice, this method is often used wrongly whether to hide bad loans or to dress-up the statements.

Recovery of bad loans may allow for sanitation, ie development of methods and actions that are carried out jointly by the bank and the borrower to prevent its bankruptcy.

Activities conducted as part of the sanitation, can be divided into those that mobilize internal reserves of the borrower (reduction in receivables, cut-off of unprofitable business units, deceleration of fixed and variable costs, selling non-core assets, etc.), and such that involves finding external sources of funding (to attract additional capital, seeking new partners, etc.). Sanitation is very expensive method, which does not give instant results, so the bank must carefully assess their capabilities and appropriateness of use.

If the loan recovery strategy recognized inappropriate or do not lead to expected results, the bank applies aggressive methods by forcing debtor to return the principal and interest (to carry out the liquidation of credit) for full reimbursement of bad debts.

Methods for elimination of credit include: enforcing the collateral, the elimination of bad debts by the guarantor (surety), insurance reimbursement from insurance agencies within the time limits specified by the rules of insurance, transfer of distressed assets under management to a third party (collector) with

optimizing bank balance, transfer / sale troubled assets of related financial company (SPV onshore / offshore); sale of distressed assets unrelated financial company under factoring, legal action (set of measures for their enforcement).

Feasibility of implementation in practice of a particular bank of these methods defined criterias such as:

- guarantee of the result, which should be considered as full repayment of principal and interest;
- costs to implement the chosen method, (the level of costs must be determined with regard to all additional expenses necessary for method implementation);
- duration of action - in this aspect the regulatory and legal framework for selected procedures should be considered, and the ability to implement them independently of the will of the debtor;
- impact on reputation - this criteria determines the validity of the chosen strategy, the possibility of further cooperation of the bank with the borrower, as well as strengthening or weakening of the position of the bank relative to other borrowers;
- potential external risks and the degree of dependence on results from external factors (market conditions, market prices for collateral, etc.)
- potential internal risks and the degree of dependence on result from internal factors.

Moreover, when choosing the method bank has to take into account the peculiarities of accounting and taxation, the impact on the adequacy of regulatory capital, level of liquidity, an increase in management efficiency, reduction of risk and profitability of the loan portfolio.

In case of failure to return bad loans, a bank can use reserve for write-off (recovery) of debt on the loan, which belongs to V (lowest / bad) quality category, in the manner prescribed by the National Bank of Ukraine [2].

We argue that it is crucial to develop and select proper methods and strategies to manage problem loans, depending on the characteristics of the bank

and the borrower, so there are objective prerequisites for further research in this area.

On the basis of developed credit policy and its' requirements, a preventive problem loans management system is implemented on a permanent basis and includes:

- monitoring of risk positions for signs that may indicate the occurrence of problem loans;
- diagnosing of the borrowers' ability to repay his debt and determination on the basis of diagnosis the characteristics of exposure (standard credit loan, pre-bad loan stage; loan with clear signs of problems).

If loan is detected to be with severe symptoms of problematic nature, it activates reactive management, which involves the introduction of measures to control bad debts.

While working with problem loans the bank can use two controlling strategies: recovery strategy and elimination strategy (Figure 1).

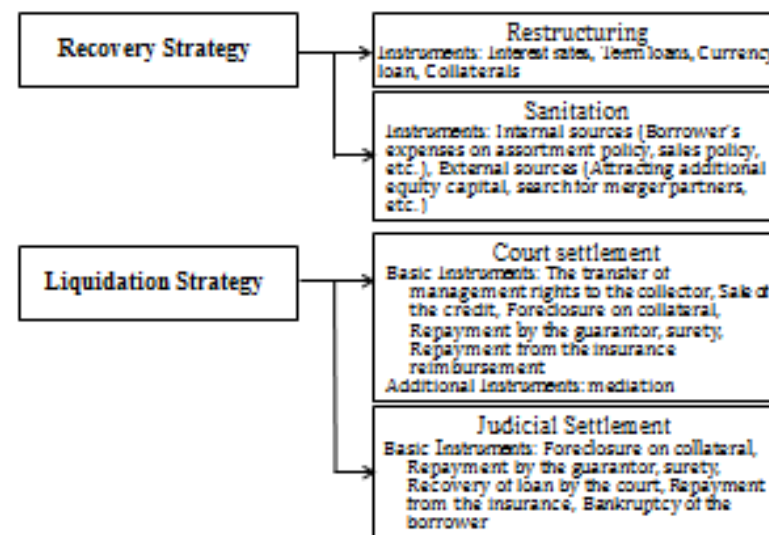


Figure 1. Support of the reactive problem loans management in bank

Restructuring (changing the initial conditions of the contract) is the main method of problem loans recovering when the debtor is unable to meet his obligations. Restructuring agreement may consist of the following elements: collateral restructuring, restructuring of a payment schedule (extension of credit term, grace periods), restructuring charges for loan (changing loan schemes from the classic to the annuity, reduced interest rate), conversion of loan and interest, write-off fines and penalties etc. [1]. The decision on restructuring must be substantiated and adopted in the same manner as the decision to grant credit. This method is effective when the problems of the borrower are temporary and are not systematic. It should be mentioned that that in domestic banking practice this method is often used wrongly to disguise bad loans and improve bank's financial ratios disclosed in reports.

Recovery of bad loans may provide for rehabilitation, ie the development of activities that are carried out jointly by the bank and the borrower to prevent his bankruptcy [1]. Measures conducted as part of the sanitation can be divided into those that mobilize internal reserves of the borrower (reduction in receivables, cut-off of unprofitable business units, reducing of the amount of fixed and variable costs, selling non-core assets, etc.), and such that involves finding external sources of funding (additional capital raising, seeking new partners, etc.). Remediation is very expensive method, which does not give instant results, so the bank must carefully assess their capabilities and appropriateness of use.

If the loan recovery strategy recognized inappropriate or does not lead to expected results, a bank applies the methods of enforcement of principal and interest (to carry out the liquidation of credit) for full reimbursement of bad debts.

Methods for liquidation of credit include: enforcing the collateral, liquidation of bad debts by the guarantor (surety), insurance reimbursement from insurance agencies within the time limits specified by the rules of insurance, transfer of toxic assets to a third party (collector) without bank's balance optimizing, transfer / sale troubled assets to independent financial company (SPV

onshore / offshore); sale of toxic assets to independent financial company under factoring, legal action (set of measures for their enforcement).

Reasonability of implementation of these methods in a particular bank's practise is defined by such criteria's as: guarantee of the result, costs to implement the chosen method, duration of action, impact on reputation, potential external and internal risks, and a degree of dependence on results from external and internal factors.

Moreover, the choice of method bank has to take into account the peculiarities of accounting and taxation, the impact on the regulatory capital adequacy, liquidity providing, increase management efficiency, reduce risk and ensure profitability of the loan portfolio.

If it is impossible to return bad loans, a bank can use formed reserves in the manner prescribed by the National Bank of Ukraine.

Conclusions. The article defines the structure of the problem loans management system in bank as the structural and functional integrity of the objects, subjects, principles and mechanism of the interaction which minimizes losses while dealing with borrowers.

We state that it is crucial to develop and select proper methods and strategies to manage problem loans depending on the characteristics of the bank and the borrower, so there are objective prerequisites for further research in this area.

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