

УДК 336.713.717

**Krukhmal O. V.**

Ukrainian Academy of Banking of National Bank of Ukraine

**REGULATION OF PROBLEM LOANS IN THE BANKS OF UKRAINE:  
THEORETICAL AND METHODOLOGICAL ASPECTS**

The author researched the methodical approaches to the management of problem loans in the banks. The author of the article described the methods of regulation of problem credits in the Bank.

**Key words:** problem loan management of problem loans, regulatory strategy of bad debts.

**Problem statement.** The current financial state of most Ukrainian banks has a negative impact on the economy of the country. Poor quality of the Ukrainian banks' loan portfolios do not allow them to carry out loan operations in the required volumes, which has led to the actual suspension of production crediting, including the investment one and, consequently, no prerequisites for extended reproduction are created. Under such conditions the problem of improving the quality of the banks' loan portfolios acquires special importance. Deterioration of the banks' loan portfolios quality not only complicates their lending activities, but also significantly affects the financial stability of the banks, decreases the banks' competitiveness and trust in the home banking system. The portfolio of the bank problem loans is one of the key indicators of the banking system financial stability.

Despite the measures taken by the banks for the purpose of loan risk management each loan bears a non-repayment risk. Therefore, the issues related to the development of the methodological approaches to the problem loans regulation are topical.

**Analysis of the Recent Research and Published Works.** The studies of approaches to the problem loans management are contained in the following scientific studies: O. V. Baranovskyi, V. S. Golub, A. M. Moroz, V. A. Alekseychuk, V. S. Andriychuk, L. O. Kovalenko, V. I. Logvynenko, A. S. Vasiurenko, I. I. Kyrylenko, V. I. Mischenko, etc. In addition, the directions of solving the problem loans repayment problems were considered in the works by K. M. Diakonova, S. A. Iliasova, A. P. Kazartseva, V. I. Krylova, O. O. Mariin, O. S. Liubun, L. D. Prymostka, V. D. Snezhko and I. V. Salo. However, in spite of numerous studies and obtained scientific outcomes obtained there remain unresolved issues, in particular, the nature of the final notion "problem loans" remains uncertain. Due to continuous changes in the banks functioning conditions the methodological approaches to the regulation of the problem loans require research.

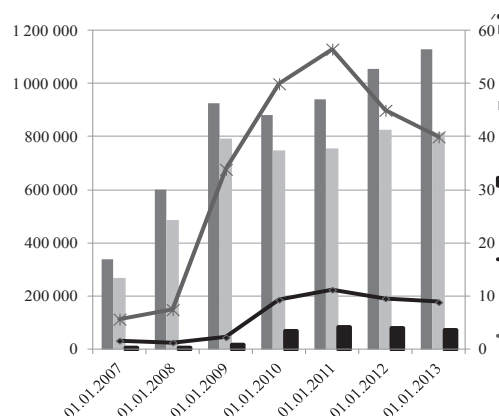
Thus, it is necessary to develop the methodological approaches to the regulation of the bank problem loans under the conditions of economic instability including the same on the basis of defining the essence of the problem loans, their classification and methods of control, which will allow for the improvement of the problem loans managing mechanism and, ultimately, the reduc-

tion of their negative impact on the banks' crediting capacity.

**The goal of our research** is the development of systematic approaches to the bank problem loans regulation on the basis of defining the essence of the problem loans, their classification with the separation of the categories of the problem loans requiring to be addressed, as well as the research and systematisation of the problem loans regulation methods.

**Description of the main material.** Loan risk has always been one of the most important issues for the banks and the emergence of problem loans in any bank is a consequence of such risk realisation.

The bad debts on loans in the Ukrainian banks remain high (Fig. 1). According to the National Bank of Ukraine data, over a period of 2012 the loan portfolios' volume of the Ukrainian banks fell by 10 billion UAH, however, during the first half of 2013 it rose by 17.59 billion UAH or by 2.16 %. It should be noted that beginning from 2011 there has been a general trend of the problem loans decline. But in the first half of 2013 the problem loans increased by 4.86% and in June 2013 they amounted to USD 76.044 billion UAH or made 10.95% of the allowed loans.



- assets of banks, billion UAH; - loans allowed, billion UAH; - loans overdue, billion UAH; - level of problem loans (NBU), %; - level of problem loans (International Rating Agency Fitch Ratings) %

**Fig. 1. Dynamics of problem loans in the banks of Ukraine in comparison with the dynamics of assets and loans allowed over a period from 01.01.2007 until 01.01.2013 [made up on the basis of 1, 2]**

According to the estimates by international agencies the share of problem loans in the Ukrainian banking system is much greater than 11% as declared by NBU.

According to the International Rating Agency Fitch Ratings the level of problem loans in the banks of Ukraine in 2012 amounted to about 45% of all loans on the Balance Sheets of the banks. The World Bank estimates the level of problem loans in Ukraine at 41%, and Moody's Rating Agency - at 35% [2].

Such difference between the NBU and the international rating agencies data is caused by the fundamental differences in the approaches to the prob-

lem loans definition of the National Bank of Ukraine and international financial institutions. And such differences lead to absolutely different assessments of the banks' problem debts. Two main differences in the assessment of problem debts may be seen.

First, in accordance with the accounting rules in Ukraine the sum of only those tranches whose maturity date has been overrun are shown on the arrears accounts in the banks. So, in Ukraine when determining the debts in arrears taken into account are only the sums of the overdue tranches. When using the international approach to determining the actual amount of the problem and potentially problem loans one should take into account the full amount of the loan if such loan is fixed as an overdue one.

Second, in the case of the problem loans restructuring the banks do not attribute it to the problem ones. International rating agencies consider such loans problematic by nature and, therefore, take them into account when calculating the banks' problem debts volumes.

Thus, the development of the bank problem debts regulation is impossible without understanding the nature of problem loans.

In the scientific studies of A. M. Moroz, V. I. Mischenko, L. O. Prymostka and other national scientists a loan is determined as a problem one, if one or several payments under it has not been made on time, its collateral market value has significantly decreased and the circumstances have arisen, which make the bank have doubts as to its repayment [3]. Thus, should the borrower overrun the loan repayment period specified in the contract or there be any deviations from the planned loan repayment schedule or upon the occurrence of other adverse changes that may cause default on the loan, it is recommended to transfer such loan to the category of the problem ones.

The Basel Committee on Banking Supervision considers that "a loan product, which is characterised by significant breaching the terms of fulfilment of obligations to the bank, signs of the debtor's financial condition worsening and significant deterioration of the quality or loss of security" [4] should be referred to the problem loans.

According to the definition of the International Monetary Fund a problem loan is the obligation whose full repayment arises doubts due to inadequate financial condition of the borrower or collateral under the given obligation, and the payment of the principal debt or interest on it is delayed for more than ninety days" [4].

The U.S. Federal Banking System applies a somewhat different approach to the definition of problem loans and deems a loan problem one, if it is unprofitable, i.e. bearing no interest, or if the interest on it is delayed for over ninety days [4].

According to the Central Bank of the Russian Federation any overdue or doubtful loan, bill or interest debts and arrears of commission should be referred to problem debts [4].

The criteria of attributing the debts to the problem category by the National Bank of Ukraine are not clearly defined in the regulatory framework.

In [6] the assets/allowed liabilities are classified into the following categories of quality: I (the highest one) - this category is characterised by the fact

that it bears no or minimal risk; II – moderate risk; III – significant risk; IV – high risk; and V – realised risk. The debt on assets/allowed financial liabilities assigned to the lowest (the fifth category) is the bad one. [6]

It should be added that the National Bank of Ukraine introduces the concept of “non-performing loans” in order to determine the key indicators of financial stability in the statistical bulletin. Until the end of 2007 the loans under control, substandard, doubtful and bad loans were included in the non-performing loans. Since 2008 the non-performing loans have included the doubtful and bad loans [7].

As recommended by the International Monetary Fund the loans are deemed non-performing, if the payment of the principal of and interest on the loan are overdue for three or months or past due for less than ninety days, but according to the national standards of supervision it is considered that the maintenance of such a loan is “weak” or “unsatisfactory” [5]. If the loan was qualified by the bank as non-performing one, it should remain in the said category until its maturity or cancellation. Any loan that replaces the non-performing one under restructuring, conversion or funding should also be classified as non-performing until its maturity. The amount of loans qualified as non-performing ones includes a total amount of debt on such loans, not just the past due amount. Today in domestic practice the non-performing loans include doubtful and bad loans and the loans that substitute for them.

The concept of “problem loans”, which includes the overdue and doubtful loans, exists in the Ukrainian banking practices along with the non-performing loans. However, NBU notes that actually only the amount of the overdue loan payments according to the financial statements, but not the total amount of loans the payments on which have been delayed [5] are referred to the problem loans.

On the basis of summarising the approaches to problem loans identification we believe that such loans should include the ones whose repayment seems to be problematic and bears the following signs: significant violation of terms of fulfilling the obligations to the bank; disruption of the payment schedule; loss of quality or decrease in the cost of the collateral; deterioration of the borrower’s financial condition; availability of negative information about the borrower’s ability to perform its obligations and other circumstances allowing the bank to have doubts as to such loans complete and timely repayment.

For the purpose of developing theoretical approaches to the problem loans regulation we propose to use an integrated definition of a problem loan and include the following types of debts in it.

The loans at the stage preceding the problem one include the debts, which are potentially problematic (the loans at the stage of intensified control), or which, with high probability, will become problematic within a short term, but still may be treated as non-problem ones (the loans at the early-warning stage) [8].

The loans with the pronounced “problem” signs include the loans whose timely repayment seems problematic (the client has committed a breach of the loan agreement, conditions of preservation and size of collateral, conditions of financial position support, etc.) and bad loans (the borrowers’ default on debts

under the internal regulations of the bank).

Each category of problem loans requires development of identification criteria, by which the bank should be guided. The given classification of a bank's problem loans should be used in the formation and justification of a complex of regulatory measures.

The problem loans management in the bank should be considered on two levels: on the preventive level in order to prevent the bad loans emergence and at the regulation level for the purpose of reanimation of the loan, which has been recognized a problem one or to reduce the bank's loss caused by the default on the loan.

Preventive management of problem loans should be carried out in the bank on a regular basis; its main goal is early detection of the signs that indicate deterioration of the borrower's financial condition, quality of collateral, loss of the loan repayment sources, etc., which may result in a problem loan origination.

It should be emphasised that preventing the problem loans origination in the bank requires the introduction of scientifically grounded loan policy, whose implementation purpose is the control over the credit risks in the course of ensuring the most efficient allocation of credit resources in order to obtain the maximum possible income from lending operations.

Credit policy should determine the following approaches used in lending and in the case of their effective implementation will help to prevent the bad loans occurrence: creation and implementation of the qualitative and quantitative credit risk assessment; standardisation of loan products, including the same through establishment of clear procedures of their granting and methods of analysis of potential borrowers in order to reduce the cost price of the loan services and improve the customer's service quality; flexibility of loan terms depending on the loan product category (software, individual, complex); integrated loan risk management implemented by the structural units of the bank within their powers both at the stage of applications consideration and when following the projects; supervision over the targeted usage of the granted loans.

Where a problem loan is identified, the bank should activate the regulating measures concerning the problem loans. The regulation provides for the introduction of a complex of measures aimed at the restoration of the borrower's solvency or search for the sources of covering for the bank's loss from the credit operation.

Thus, two main strategies for the banks' concerning the problem loans regulation may be distinguished: the loan quality renewal strategy and the loan liquidation strategy.

The main method of the problem loan recovery is its restructuring, which is an agreement between the borrower and the lender; it provides for a new loan scheme application, change of maturity date or providing a grace period for the loan repayment. Such agreement should restore the borrower's ability to meet its obligations. In addition to changing the loan repayment conditions the agreement of loan restructuring may include the following elements: alteration of the volume (value) and support structure, change of the loan inter-

est rate, replacement of the loan currency, conversion of the loan and interest thereon, and writing off the fines and penalties on the loan. The main tools used by the bank in the loan restructuring are the repayment period, interest rate, loan currency and collateral.

Besides restructuring, the bank, for the purpose of restoring the borrower's solvency, may offer reorganisation, which consists in the development and implementation of a system of measures that are jointly carried out by the bank and borrower in order to avoid bankruptcy of the latter. The objective pursued by the bank in reorganisation is to find sources of the loan repayment: internal ones - by optimising the borrower's activities or external ones - by attracting additional capital, new partners, etc. The reorganisation will not allow a quick recovery of the loan. So, when resorting to reorganisation the bank should carefully weigh the need of its implementation and the success probability as a result of it.

Should the loan recovery strategy be recognized as an inexpedient or yield no expected results, the bank applies the methods of the loan and interest forced levy. The methods a loan liquidation are: realisation of collateral, debt collection at the guarantor's expense, insurance compensation, transfer of the impaired assets management to third person (collector) without optimising the bank's Balance Sheet, transfer or sale of the impaired assets to a related financial company on the basis of optimising the Balance Sheet (SPV onshore/offshore), sale of the impaired assets to an unrelated financial company under conditions of factoring, asset securitization, etc. [9], and also legal collection of loans - a set of debt forced levy. In case of failure to return a problem loan the bank can make use of the formed reserve for writing-off (compensation for) the debt of the loan referring to quality category V (the lowest/bad one) in accordance with the procedure prescribed by the National Bank of Ukraine [6].

To date the Ukrainian banks actively clear their loan portfolios from problem loans by writing off such loans or selling them. The procedure for the loans writing-off has been facilitated thanks to the tax liberalisation as a result of arrangements between NBU and the State Tax Administration at the end of 2011 to sell the share of problem loans (as for example was done by Bank Forum, UkrSibBank, Swedbank, etc.).

The intermediaries collecting the problem debts today are really in demand in Ukraine. The banking institutions are technically and organisationally unprepared for large-scale works associated with the return of overdue debts, may lead to a further increase in the problem loans number, destabilisation of the banks' work, problems with investors, etc. However, for the banks the sale of the loans is a forced and often inefficient way of work with the problem loans. Some categories of the debts are almost never passed on to the collectors by the banks; those are mortgage, car and other loans that have liquid and not depreciated collateral. Collectors are transferred small loans the problems with arose more than half a year ago.

Besides, it is advisable to pay attention to the fact that collection activities in Ukraine are legally unadjusted, that no law is available on collectors' activities, and note the bill on banning the collection services provision to natural person borrowers filed in November 2011. We believe that in the near



future in Ukraine revitalization of the activities of the independent professional market players dealing in the problem debts collection will be observed, but complete shifting of the problem debts collection functions onto the intermediaries is inexpedient.

So, banks should carefully approach the problem debts regulation by both applying preventive measures and activating the work improving the formed loan portfolio. In addition, further development of the independent market professionals dealing in the problem debts collection will be conducive to the process of collecting the problem debts.

### **References:**

1. Osnovni pokazniki diyalnosti bankiv Ukrayini [Elektronniy resurs] : Rezhim dostupu : [http://www.bank.gov.ua/Bank\\_supervision/index.htm](http://www.bank.gov.ua/Bank_supervision/index.htm).
2. Pechorina N. Ekspert: Zbitki ukrayinskih bankiv u veresni pov'yazani z visokim rivnem problemnih kreditiv [Elektronniy resurs] : Rezhim dostupu : [http://www.ukrinform.ua/ukr/news/ekspert\\_zbitki\\_ukrayinskih\\_bankiv\\_u\\_veresni\\_povyazani\\_z\\_visokim\\_rivnem\\_problemnih\\_kreditiv\\_1767460](http://www.ukrinform.ua/ukr/news/ekspert_zbitki_ukrayinskih_bankiv_u_veresni_povyazani_z_visokim_rivnem_problemnih_kreditiv_1767460)
3. Aleksandrov A. Yu. Upravlenie portfelem problemnyh kreditov kommercheskogo banka [Tekst]: avtoref. dis. na soiskanie uchen.stepeni kand. ekon. nauk: 08.00.10 / Aleksandrov Andrey Yurevich. – Sankt-Peterburg, 2010. – 23 s.
4. Moroz A. M. Kreditniy menedzhment [Tekst] : navch. posibnik / Moroz A. M. – K. : KNEU, 2009. – 540 s. – ISBN 978-966-368-041-5.
5. Glosariy bankivskoyi terminologiyi [Elektronniy resurs]: ofitsiynе Internet-predstavnitstvo Natsionalnogo banku Ukrayini – Rezhim dostupu: [http://www.bank.gov.ua/control/uk/publish/article?art\\_id=124734&cat\\_id=124733](http://www.bank.gov.ua/control/uk/publish/article?art_id=124734&cat_id=124733).
6. Pro porядok formuvannya ta vikoristannya bankami Ukrayini rezerviv dlya vidshkoduvannya mozhlivih vtrat za aktivnimi bankivskimi operatsiyami [Elektronniy resurs]: polozhennya, zatverdzhene postanovoyu Pravinnya Natsionalnogo banku Ukrayini vId 25.01.2012 r. # 23. – Rezhim dostupu: <http://zakon1.rada.gov.ua/laws/show/z0231-12>.
7. Statistichniy byuleten bankiv [Elektronniy resurs]: sayt Natsionalnogo banku Ukrayini. – Rezhim dostupu: <http://bank.gov.ua/files/stat.pdf>.
8. Kruhmal O. V. Rozvitok metodichnih pidhodiv do upravlinnya problemnimi kreditami / O. V. Kruhmal, O. A. Kriklii // V kn. : Teoretiko-metodologichni zasadi priskorenniya protsesiv sotsialno-ekonomichnogo rozvitku regionu [Tekst] : kolektivna monografiya / Za zag red. P. I. Sokurenka. – Kremenchug : PP Scherbatih. – 2013. – S. 308-319.
9. Osadchiy I. Shiyahi vdoskonalennya roboti z problemnimi aktivami bankiv Ukrayini [Tekst] / I. Osadchiy // Visnik unIversitetu bankivskoyi spravi Natsionalnogo banku Ukrayini. – 2011. – #11. – S. 11-16

### **Крухмаль О. В.**

ДВНЗ «Українська академія банківської справи  
Національного банку України»

### **РЕГУЛЮВАННЯ ПРОБЛЕМНИХ КРЕДИТІВ В БАНКАХ УКРАЇНИ: ТЕОРЕТИЧНІ ТА МЕТОДИЧНІ АСПЕКТИ**

#### **Резюме**

Досліджено методичні підходи до регулювання проблемних кредитів в банках. Надано характеристику методам регулювання проблемної заборгованості в банку.

**Ключові слова:** проблемний кредит, управління проблемними кредитами, стратегія регулювання проблемної заборгованості.

**Крухмаль Е. В.**

ГВУЗ «Украинская академия банковского дела  
Национального банка Украины»

**РЕГУЛИРОВАНИЕ ПРОБЛЕМНЫХ КРЕДИТОВ В БАНКАХ УКРАИНЫ:  
ТЕОРЕТИЧЕСКИЕ И МЕТОДИЧЕСКИЕ АСПЕКТЫ**

**Резюме**

Исследованы методические подходы к регулированию проблемных кредитов в банках. В статье охарактеризованы методы регулирования проблемной задолженности в банках.

**Ключевые слова:** проблемный кредит, управление проблемными кредитами, стратегия регулирования проблемной задолженности.