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N.K. Poletayeva,

N.S. Korablyova

Innovative University of Eurasia (Pavlodar)

E-mail: nat-poletaeva@yandex.ru, wloviewme@mail.ru

### Credit portfolio management of a commercial bank: problems and ways of their solution

**Annotation.** Today, management of credit portfolio is the key question of the commercial bank credit activity. In the paper the main problems of credit portfolio management of a commercial bank are presented and the description of the activities for their solution is given.

**Keywords:** banking system, credit portfolio of a commercial bank, credit risk, diversification of credit portfolio, securitization, credit restructuring, credit refinancing.

The banking system of Kazakhstan for a long time was considered as the best in the CIS. Unfortunately, today it isn't true. The banking system of Kazakhstan is ranked first in the world in terms of non-performing credits to the economy - 31.7 percent. This circumstance makes credit portfolio management a priority in the activities of a commercial bank.

The forecast of Kazakhstani banking system remains negative according to the report of the international rating agency "Moody's Investors Service". The forecast reflects the expectation of necessity of more efficient actions to cover losses on large volume of problem credits. These risks are increased by the recent devaluation of tenge in relation to US dollar for 19 percent and proceeding expansion of banks in consumer segment of crediting. Nevertheless, Moody's also recognizes that, despite the recent devaluation, the macroeconomic environment in Kazakhstan is rather stable.

The "problem credits" are the credits for which after the issue on time and in full the obligations are not met by the borrower or the value of collateral has decreased significantly.

According to the agency, the weak quality of assets will remain the key credit problem for Kazakhstan banking system in the next 12-18 months. The rating agency expects that the problem credits will still make more than 40 percent of all credits to the end of 2014.

In table 1 the description of the quality of credit portfolio of the largest banks of the Republic of Kazakhstan for 01.01.2014 is given.

The leader in the share of problem loans among the largest banks in the Republic of Kazakhstan is a twice restructured JSC "BTA Bank" - 87.41 percent, and the loans with payments overdue more than 90 days accounted for 86.51 percent. Then, as one of the "daughters" of Russian banks JSC "Sberbank" showed the smallest share of problem loans - 2.94 per cent, and the loans with payments overdue more than 90 days accounted for 2.14 percent.

Table 1 – Quality of Credit Portfolio on the Largest Banks of the Republic of Kazakhstan for 01.01.2014

Bank	Credit portfolio	The credits with delay of payments		The credits with delay of payments over 90 days	
		sum, thousand tenge	share in credits, %	sum, thousand tenge	share in credits, %
«Kazkommertsbank» JSC	2 481 823 057	832 725 695	33,55	730 091 666	29,42
«Halyk Bank» JSC	1 736 226 241	298 811 332	17,21	282 979 584	16,30
«BTA Bank» JSC	2 381 329 689	2 081 468 404	87,41	2 059 976 952	86,51
«Bank CenterCredit» JSC	887 328 230	189 911 133	21,40	145 042 869	16,35
«ATFBank» JSC	716 803 405	318 480 250	44,43	293 804 732	40,99
«Sberbank» SB JSC	798 661 465	23 491 358	2,94	17 084 910	2,14
«Tsesnabank» JSC	664 396 455	32 963 204	4,96	24 892 136	3,75
«Alliance Bank» JSC	585 072 288	339 573 842	58,04	291 254 865	49,78
«KASPI BANK» JSC	714 337 238	157 131 048	22,00	87 388 665	12,23
«Eurasian Bank» JSC	445 385 837	57 707 049	12,96	39 643 777	8,90
TOTAL	11 411 363 905	4 332 263 315	37,96	4 187 572 766	36,70

The Kazakhstani banks, besides regulator pressure, are experiencing now a serious competition from the foreign credit organizations. In particular, the group of "daughters" of Russia banks for a year increased the total volume of the credits by 43 percent, whereas all banking sector of Kazakhstan on the credits grew by 13,5 percent. The Russian group has all prerequisites for increasing the sphere of influence in the domestic credit market.

The presence of problem credits causes the necessity to form provisions according to International Financial Reporting Standards (further – IFRS).

The classical understanding of provisions is the recognition of probability of the concrete asset cost losses, for example, the provided credit. The provisions created on loan portfolio according to the requirements of IFRS made up 34,7 percent in 2013 from a loan portfolio of the second level banks of the Republic of Kazakhstan. This, in its turn, caused the decrease of net profit and profitability of commercial banks.

The above-mentioned stresses the importance and the need of credit portfolio management of commercial banks of Kazakhstan.

Figure 1 shows the problems of credit portfolio management that are inherent in the banking system of Kazakhstan.

The diversification is the way of reduction of cumulative susceptibility to risk due to the decrease in the greatest possible losses for one event. The diversification increases the quality of credit portfolio, lowers the general risk level, but demands professional management and good knowledge of the market. Through the diversification of credit portfolio the system of restrictions (limits) is recommended. In the increase of certain limits the necessity of the decrease of others for saving required general risk level of all portfolios is taken into account.

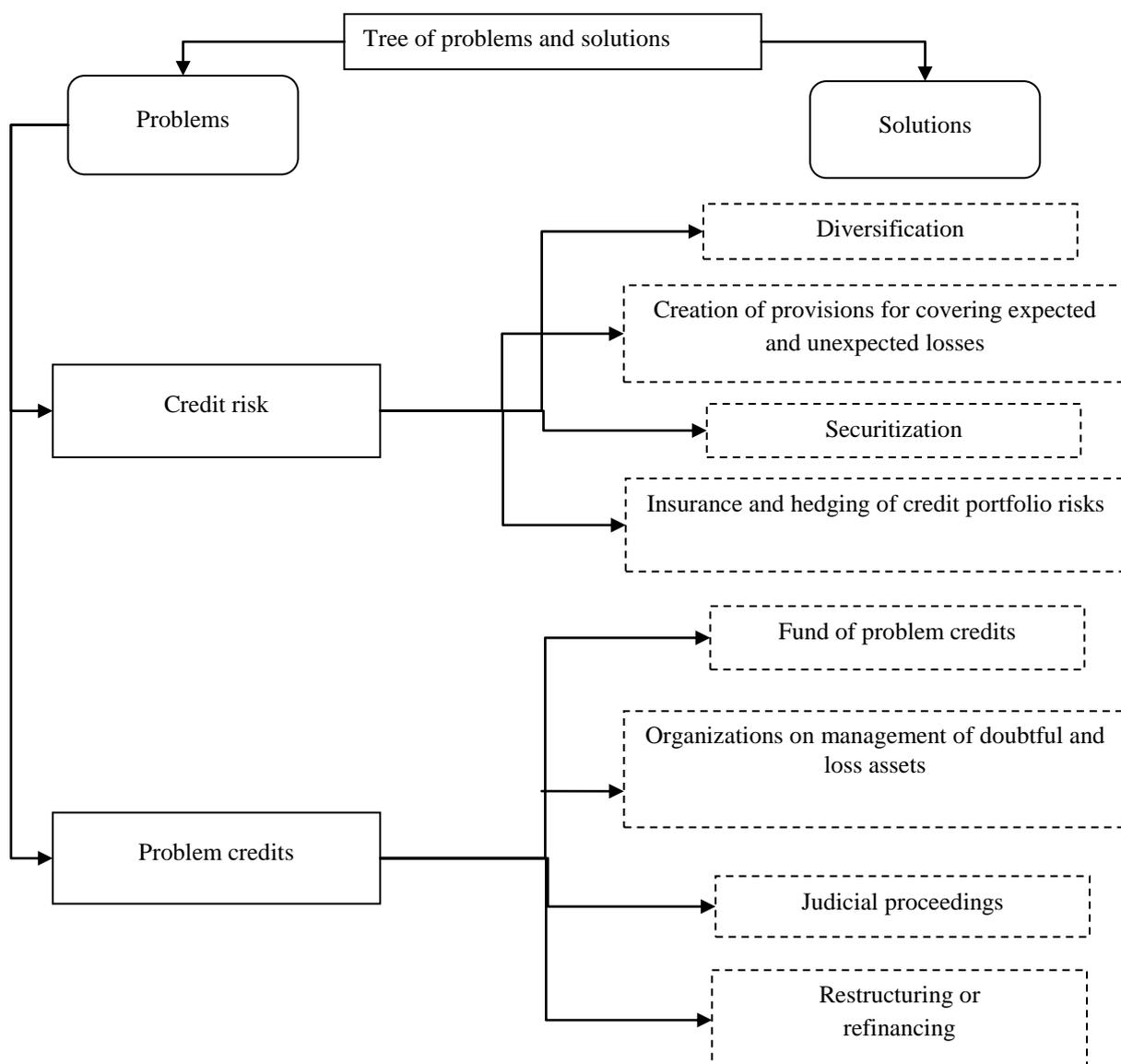


Figure 1 - Problems of credit portfolio management of a commercial bank and ways of their solution

To minimize the consequences of risks arising during carrying out credit operations, the classification of credit portfolio and reservation of necessary funds by making provisions is carried out. Reservation is creation of provisions in case of unfavorable changes in bank activity. Due to the changes to article 43 of Law of the

Republic of Kazakhstan “On Banks and Banking Activity in the Republic of Kazakhstan” banks are obliged to make provisions according to International Financial Reporting Standards.

Securitization should be understood as the transformation of bank assets into securities, transfer of a certain part of credit risk to the third parties that allows to lower requirements on the capital. Securitization is one of alternative ways of capital attraction; it allows to expand volumes of crediting and promotes long-term crediting development. The alternative way close to securitization is the application of the right of the credit sale, that is in the broadest sense the word “securitization” means not only transformation of the credits into securities, but also any transfer of them into such form that the third parties can realize them in the market.

Insurance does not aim to decrease the probability of risks, and is aimed mainly to compensate the material damage from the risk manifestation. Most of the risk or the entire risk is transferred from the insured to the insurer. [1].

It should be noted that the banking system of Kazakhstan has been experiencing the problems of deterioration of the quality of credit portfolios for the last five years and that is connected with the situation in the world financial markets. The Government and the National Bank of RK undertook a number of measures for stabilizing the situation, preventing the system crisis and default of Kazakhstani banks.

In recent years Kazakhstani banks have been working independently with the problem credits, though it would be better if the agencies on collecting debts (or collection agencies) did that. The Agency on collecting debts has been working at the market of the Republic of Kazakhstan since 2007. In 2008 they started creating the Distressed Assets Fund. This Fund is one of elements of the complex of measures on reducing the system risk in the economy, arisen as a result of a global economic crisis. The government undertakes these measures to ensure the stability of the financial system by improving the quality of the banking sector assets and increasing the trust to Kazakhstani banking sector. Unfortunately, the Distressed Assets Fund didn't fulfill the functions assigned to it.

At the same time the problem of the quality of credit portfolio of Kazakhstani banking sector hasn't been solved and this negatively influences the development of the economy and financial system.

To solve the problem related to the improvement of the quality of credit portfolio, a two-level system on repurchasing the assets of the banks of the second level has been created in Kazakhstan. It is presented in figure 2.

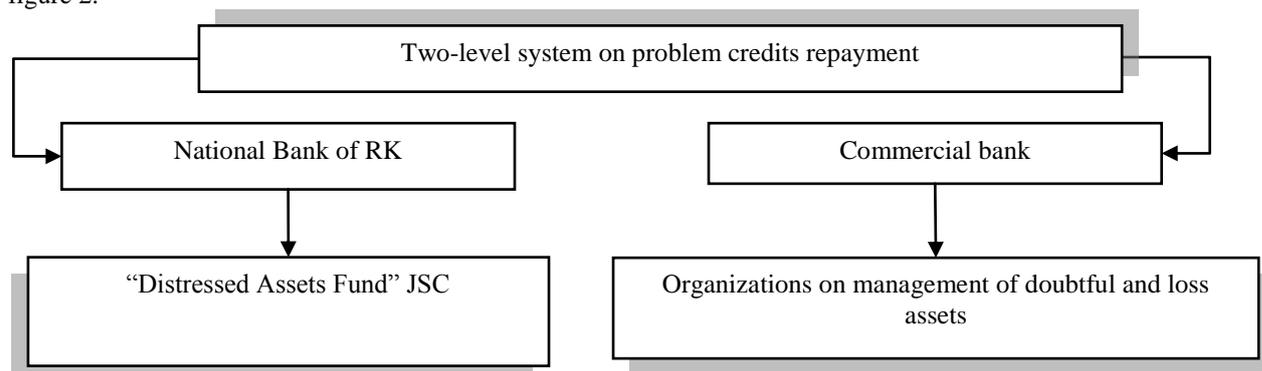


Figure 2 - Two-level system on purchasing problem credits

In April, 2012 the National Bank of RK declared about the creation of “Distressed Assets Fund” JSC. “Distressed Assets Fund”, JSC was registered in organs of justice on January 11, 2012. The only shareholder of the Fund is the National Bank of the Republic of Kazakhstan. The main purpose of the Fund's activity is implementation of measures directed at the quality improvement of credit portfolio of the second level banks in accordance with the requirements of regulations of the authorized structure.

The main activities of the Fund are:

- repurchase of problem credits of the second level banks;
- management of the repaid assets of the second level banks;
- issue of debt securities for financing of their activity.

However, the possibilities of assets acquisition by the Fund are significantly limited, [2] the capitalization of two billion dollars is insufficient for repaying a considerable volume of debt from banks. At the moment the Fund's activity is complicated by the objective obstacles arising in view of legislative requirements, or unwillingness of banks to transfer problem assets at the fund cost.

As an alternative measure for problem solving connected with the improvement of credit portfolio quality, Kazakhstani banks are allowed to create specialized subsidiaries on managing stressful assets which, according to the current legislation, have the right to realize the part of the “problem” credits to the Distressed Assets Fund.

According to the law “About banks and bank activity” credit institutions have the right to create the companies on problem assets management. Further, it is supposed that stressful assets will “be dumped” on the

balance of these companies, then shareholders consider variants of their rehabilitation and sale or bankruptcy. The majority of banks, according to the National bank rating, prefer to work with their own subsidiary, to transfer assets in the collection organizations, or to operate assets independently.

At the same time, these specialized subsidiaries on managing stressful assets have the same rights as the Fund including the right to enter the capital of the indebted company, to manage the real estate collateral, for example, to lend it and at the expense of the gained profit to repay the credit.

This mechanism is more attractive for a bank because it allows to operate problem credits independently by implementing the earlier forbidden non-bank activity.

The important decision of improving the quality of credit portfolio is restructuring of problem credits.

Credit restructuring as the main method of the banks' work with problem credits can be carried out by introducing changes and supplements to the terms of the signed contracts in the form of granting concessions to the borrower in connection with deterioration of his financial position.

The bank restructures the credit to reduce the potential losses on credits when clients due to economic, legal or other reasons face financial difficulties. Restructuring is considered as a way to increase the probability to repay the remained debt.

The examples of the credits restructuring are writing down of the principal debt and (or) interests, reduction of the interest rate and (or) increase in maturity of the principal amount of a loan and (or) interests.

Prolongation and delay of planned payments are a restructuring component. Change and (or) delay of planned payments on the credit, not connected with deterioration of financial condition of a borrower, aren't restructuring. The decision on the credit restructuring is made by the relevant credit committee.

The application of the credit restructuring is possible in the following cases:

- in force majeure situations (natural disasters, epidemic, military operations and at other events which have occurred not because of the client);
- the death of a borrower, in this case concerning credit restructuring in a bank can address the successor of the borrower or the relative of the borrower;
- bringing a borrower to criminal prosecution with serving of punishment term in imprisonment places, in this case concerning restructuring, the relative of the borrower can apply to the bank;
- the state of the borrower's health (serious illness which can influence the cash flow violation on business or source of funds at the expense of which the credit repayment is made);
- other reasons which can lead to financial difficulties of a borrower that are confirmed with the relevant act.

The credit can be restructured no more than two times within one operating credit of a borrower. In case if it is expedient to make credit restructuring more than two times, the question of the credit restructuring is considered only by a bank credit committee.

The borrower of a bank or another interested person has the right to apply to the relevant bank division concerning restructuring (for prolongation, delay of planned payments) of debts on the credit by providing the written application. The basis for decision-making on restructuring is the application of a borrower and other people.

The application of a client is submitted in the written form addressed to the vice-chairman of the board supervising the questions of crediting (or the managing director of a branch bank) and has to reflect the following moments:

- reasons and explanation of restructuring;
- the period and amount of the credit to be restructured;
- provision of the credit (in case of loss of the original value of the collateral or increase of risks);
- borrower's proposals to get out of this situation.

If the credit has collateral in the form of the credit from third parties, and (or) there are guarantors it is necessary to get also consent from these individuals to restructure the credit. Written consent must be submitted to the Credit Committee, together with the application of the borrower or the application must be submitted together.

On the basis of the positive decision on carrying out restructuring of the credit the additional agreement about changes of terms of the credit agreement and (or) the pledge contract is concluded.

In case the credit committee refuses to satisfy the application in credit restructuring, the letter (notice) on refusal is sent to the applicants.

Credit refinancing, as well as restructuring, is the tool using which the borrower can decide the financial problems and provide normal payment of the existing credit. These definitions are often mixed up, however, it is incorrect.

If restructuring means modification of already existing credit agreement, then when refinancing the borrower must conclude an absolutely new agreement. And, such an agreement can be written both in that bank the borrower has already a credit, and in another one, that is naturally impossible when restructuring.

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## ТҮЙІН

***Н.К. Полетаева,***

***Н.С. Кораблёва***

*Инновациялық Еуразия университеті (Павлодар қ.)*

### ***Коммерциялық банк несие портфелмен басқару: мәселелері және шешу жолдары***

*Бүгін коммерциялық банктің несие портфелімен басқару несие қызметінің маңызды сұрағын болып көрінеді. Мақалада коммерциялық банктің несие портфелін басқарудың негізгі сұрағын таныстырылған және оның шешімі бойымен шараларды сипаттама берілген.*

***Түйін сөздер:*** банк жүйесі, коммерциялық банктің несие портфелі, несие тәуекелі, несие портфелінің диверсификациясы, секьюриттеу, несиенің қайта құрылымдауы, несиенің қайта қаржыландыруы.

## РЕЗЮМЕ

### ***Управление кредитным портфелем коммерческого банка: проблемы и пути решения***

***Н.К. Полетаева,***

***Н.С. Кораблёва***

*Инновационный Евразийский университет (г. Павлодар)*

*Сегодня управление кредитным портфелем является ключевым вопросом кредитной деятельности коммерческого банка. В статье представлены основные проблемы управления кредитным портфелем коммерческого банка и дана характеристика мероприятий по их решению.*

***Ключевые слова:*** банковская система, кредитный портфель коммерческого банка, кредитный риск, диверсификация кредитного портфеля, секьюритизация, реструктуризация кредита, рефинансирование кредита.