



## **MECHANISMS FOR REDUCING PROBLEM LOANS BY COMMERCIAL BANKS**

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### **Abstract**

The article deals with the issues of improving the efficiency of banks with overdue debts. The most effective methods of reducing the risk of problem loans, eliminating their occurrence factors and improving the loan portfolio are identified. The analysis of existing problem loans in the loan portfolio was also carried out and gave practical suggestions for their elimination.

**Keywords:** bank, banking, credit, lending, borrower, overdue debt, problem loan, credit monitoring, Non-performing loan.

### **Introduction**

Today, banking is one of the fastest growing systems in the economy of the Republic of Uzbekistan. However, this rapid growth threatens the quality of assets (including





loans) and the ability of banks to manage credit risk, and the issue of improving the way commercial banks deal with problem loans remains relevant.

As the President of the Republic of Uzbekistan Sh.M.Mirziyoev noted, "the repayment of problem loans should further expand the capacity of banks, banks, borrowers, companies and associations, heads of regions should work together to collect them.". The Bank's goal in risk management is to ensure the return of all assets and to narrow the boundaries of possible fluctuations.

Typically, when talking about risk, experts refer primarily to credit risk, i.e. the risk of non-repayment of credit and interest accrued on it. This level of risk is influenced by one of the factors that greatly influences the composition of the client and its assessment - the method of calculating the creditworthiness of the client. To reduce credit risk and the number of problem loans, it is necessary to carefully assess the creditworthiness of customers and choose an effective way to manage their risks.

This creates a need to improve the practice of collecting existing problem loans in the loan portfolio of commercial banks and is one of the important conditions for the development of the banking system.

## **Literature Review**

With the formation of market relations in the economy, there is a need to conduct research in the field of problem loans in commercial banks. Study of the analysis of problem loans in the banking system using various methods from foreign researchers associated with the names of Lavrushina, Yu.S., Nurzat OA, Lykova NM, Kovanyov AA, Yashin MV, Slavyansky AV, Kuznitsov S.V.

A number of international studies in the field of problem credit management have been devoted to the selection of the optimal strategy for the management of problem loans, these studies reflected in the works of western researchers such as Herring R.Dj., Greppet Dj.M., Karele G.V., Riddou T.Dj, Viatt SB., Greaves R.

Credit risk in commercial banks and problems with managing problem loans and minimizing their number were reported by T.M. Karaliev, U.A. Tuxtabaev, K.A. Analyzed by Mukhamedjanov et al.

Researcher Kuznitsov S.V. (2008) states in his scientific work: - Problem loan is a loan in which the borrower is unable to fulfill its obligations in full in accordance with the agreements and arrangements with the bank, so the overdue payments on the borrower's loan obligations are at risk of partial or complete loss for the bank [1].

Yu.Yu. Platonov and S.E. According to Zaychenko (2011), an increase in the number of problem loans can lead to a deterioration in the quality of the bank's loan portfolio,





additional costs, low profits or losses, and the need to organize the management of problem assets using the most effective tools. [2].

Researcher in problem loans A.V. According to Slavyansky (2009), a “problem loan” is a loan in which the borrower fails to meet the terms of the loan agreement for timely and full repayment of the loan, and the bank also has sufficient grounds for non-compliance by the borrower. [3].

O.A. Yusupova’s (2016) scientific article argues that overdue debt is caused not only by difficult financial or unforeseen circumstances, but also by customer distraction, resulting in her forgetting to make timely payments when she has the money and the opportunity. [4]. As a rule, in such cases, the overdue debt is settled by a maximum of five to seven working days by SMS notification sent to the borrower by the credit inspector, or by text message.

V.V. Mazurin's (2016) scientific article noted that an overdue loan does not allow the borrower to repay the debt in full and on time under the current contract.. However, he noted that the concept of problem loans is mainly associated with a high level of financial losses for the bank due to the wrong approach of the borrower to the loan, and this situation is often associated with the deterioration of the borrower's financial condition [5].

According to the Basel Committee, a problem loan is a loan with a significant breach of the borrower's obligations to the bank, a significant deterioration in the financial condition of the borrower and a significant decrease or even loss of collateral quality [6].

Taking into account the above, we can observe the relevance of the scientific work carried out by these researchers in the case of problem loans in commercial banks of the country.

Indeed, existing overdue and problematic loans in commercial banks not only have a negative impact on asset quality, but also increase the risk of non-repayment of loans.

## **Methodology**

This article analyzes the current state of implementation of the existing practice of collecting problem loans in commercial banks and identifies factors affecting the stability of the bank's loan portfolio. The methods of scientific abstraction, expert evaluation, induction and deduction, comparison, systematic analysis were used in the analysis process.





## Data Analysis

The occurrence of problem loans is related to the impact of credit risk, as a result of which the bank is concerned that the borrower will not be able to repay its obligations under the loan agreement in a timely and complete manner and the bank may incur losses related to lending to such borrowers. Therefore, in banking practice, problem loans are often referred to as low quality loans. This interpretation of problem loans focuses on losses resulting from problems. However, not every problem loan ends with losses. The bank's task is to prevent or minimize potential losses.

An analysis of foreign research in the field of problem credit management shows that the most effective strategy for efficiency is a problem loan management strategy aimed at the financial recovery of a borrower experiencing difficulties, which is implemented within a strategic partnership with the client.

From the methodological point of view of problem loan debt, it is important to systematize the indicators according to the content of the concept of "problem" on the loan. Different interpretations of the concept of "problem" applied in theory and practice allow the systematization of problem loans depending on the sources of loan repayment (primary and secondary) and the parameters of credit risk assessment (real and probable).

The proposed indicators for problem loans in commercial banks are shown in the table below.

Table 1 Matrix of indicators of bank credit problems

Indicators of problem loans	Indicators of real losses	Indicators of potential losses
Indicators of loss of primary resources	<ul style="list-style-type: none"><li>* <b>Overdue payments on principal and interest;</b></li><li>* <b>Bankruptcy of the borrower.</b></li></ul>	<ul style="list-style-type: none"><li>* Deterioration of the borrower's financial condition and working conditions to ensure adequate cash flows to repay loan obligations;</li><li>* Revision of the principal and part of the interest on the loan;</li><li>* Availability of information that the borrower has not fulfilled its obligations to other creditors;</li><li>* The bank does not have up-to-date and reliable information on the financial and economic condition of the borrower and his working conditions;</li><li>* Availability of information about the problems of persons who are closely related or related to the borrower.</li></ul>



Indicators of secondary resource loss	* Loss of collateral due to lack of credit and / or insolvency of the borrower's guarantee or guarantor.	* Deterioration of credit security on secondary sources of loan repayment (violation of collateral, reduction of the existing market for the sale of collateral and reduced conditions for the conversion of mortgaged property into cash, deterioration of the financial situation and business conditions of guarantors), • bankruptcy of the debtor.
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In banking practice, the primary sources of loan repayment are income from the sale of goods and services by a legal entity and income of an individual. The availability of sufficient primary resources means that the borrower is able to generate sufficient cash flows to fully meet its obligations to the bank on loan repayments. Secondary sources usually mean that the borrower will not be able to repay the loan to the current income account. Secondary sources of loan repayment include property collateral, guarantees, sureties, and credit liability insurance. When they are used to repay a loan, cash flows are generated at the expense of guarantors, or insurance companies, as a result of the sale of the mortgaged property, rather than during the borrower's current activities.

The normal course of a loan agreement in the stages of credit operations under the concluded loan agreements indicates the "smooth execution" of the bank loan, and, conversely, the occurrence of violations during the execution of the loan agreement indicates the nature of "problem loans". Figure 1 shows the stages of credit operations.

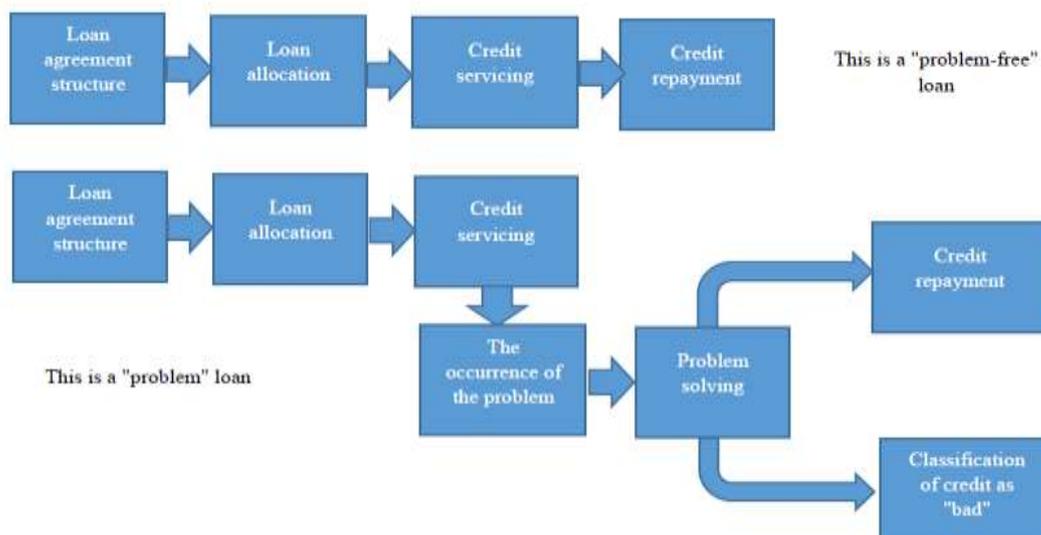


Figure 1. Stages of credit operation



At the initial stage, a loan agreement is concluded between the bank and the borrower in the form of a bilateral binding legal agreement. The loan agreement sets out the terms of the loan. Once the loan agreement is signed, access to credit resources will be available. The loan can be disbursed on the condition of a one-time loan or the provision of funds (credit line) for a certain period of time. If the borrower meets both the interest rate and the principal service requirements on the principal payments until the loan amount is repaid in full, the loan will remain valid. Then one of two options happens: either the loan is repaid on time, or the loan becomes a problem. If the borrower repays the principal and accrued interest on the loan in a timely manner, this indicates that the loan transaction is proceeding normally. The final stage of a "problem-free" loan agreement is the return to the bank of the loan amount provided to the borrower for temporary use and the accrued interest on the loan in full under the terms of the loan agreement and the completion of the relationship between the bank and the borrower. If the loan is broken by the borrower during the servicing process, this indicates that the loan agreement is "problematic". To ensure compliance with the terms of the loan agreement, the bank must take a series of actions, if the action is successful, the loan is returned to the bank, and if unsuccessful, the borrower's debts are recorded for losses of the commercial bank.

## Discussions

We analyze the effectiveness of methods of working with problem loans in the loan portfolio of commercial banks on the example of several banks with state participation, operating in the Republic of Uzbekistan for more than ten years, with a stable credit rating.

Along with the rapid growth of current loans, the volume of overdue and problem loans of banks today is 2-3%, and in some cases 3-5% or more of the bank's loan portfolio, and the growth rate is growing.

Table 2 Information on problem loans (NPL) of commercial banks as of May 1, 2020 [7]

No	Bank	Loans (billion soums)	Problem loans (NPL) (billion soums)	The share of problem loans in total loans
Total		188 326	4 470	2,3%
1	NBU	58 730	1 411	2,4%
2	Joint-Stock Commercial Bank "Uzpromstroybank"	33 471	378	1,1%
3	Joint-Stock Company "Asakabank"	29 742	942	3,2%
4	Joint-Stock Commercial Mortgage Bank "Ipoteka Bank"	20 174	489	2,4%
5	Joint-Stock Commercial Bank "Agrobank"	20 448	260	1,3%
6	Joint-Stock Commercial People's Bank of the Republic of Uzbekistan	14 219	824	5,8%
7	Joint-Stock Commercial Bank "Qishloq Qurilish Bank"	11 541	166	1,4%



The data in Table 2 show that not all methods used in the internal practice of lending in banks to deal with overdue loans do not always give the expected result. In such cases, management should consider the effectiveness of banking operations and make changes to the structural units and working methods.

## Conclusion

In accordance with the goals and objectives of this article, a set of measures aimed at collecting and improving the quality of problem loans in commercial banks may include the following actions:

- ✓ Measures to improve the loan portfolio of banks and the quality of projects;
- ✓ Opportunities to apply stress-testing practices to loans available in banks' loan portfolios;
- ✓ Develop an effective mechanism for maintaining the quality of the loan portfolio with a detailed analysis of problem loans by classification;
- ✓ Development of specific measures to restore the financial capacity of each client who is in a difficult situation after the registration of loan portfolios of commercial banks.

It is also necessary to pay attention to the following effective measures to eliminate the share and reduce the share of existing problem loans in the loan portfolio:

- Attracting additional collateral: additional guarantees or sureties, collateral for property or real estate;
- Sale of collateral;
- Repayment of the loan by selling the borrower's assets, preventing investment in low-income assets;
- Imposing sanctions on customers;
- Repayment of the loan by attracting additional funds and financial assistance from the borrower.

Thus, the research of this article, based on the formed practical actions, proposed a scientific-methodological approach to the organization of the system of management of problem loans of borrowers. It pays special attention to the early detection of problem loans, and has the opportunity to apply all the recommendations in banking practice, which will increase the efficiency of the process of managing problem loans.





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