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IMPROVING THE MANAGEMENT OF NPLs AND THE SALE OF PROPERTIES ON THE BANK'S BALANCE SHEET

Abstract

In the research were used the variables of the Azerbaijani Banking System and the Azerbaijan economy, to improve the management of NPLs and the sale of properties on the Bank's balance sheet.

Non-performing loans (NPLs) have emerged as a significant concern in the global financial landscape. These loans refer to those on which borrowers have failed to make scheduled interest or principal repayments for a specified period, often 90 days or more. NPLs pose risks to both financial institutions and the overall economy, making it crucial to comprehend their impact and find effective solutions.

Non-performing loans create a host of problems for banks and financial institutions. When borrowers default, lenders face reduced profitability, strained liquidity, and increased provisioning requirements. The resulting erosion of capital can weaken the stability of the financial system. Furthermore, NPLs hinder banks' ability to lend to productive sectors, stifling economic growth.

The reasons behind non-performing loans are multifaceted, including economic downturns, weak risk management, and inadequate underwriting standards. Effective risk assessment, early detection of troubled loans, and proactive loan restructuring are crucial to mitigating the impact of NPLs.

Addressing non-performing loans is vital for ensuring financial stability and promoting sustainable economic growth. Governments, regulators, and financial institutions must collaborate to develop robust frameworks for loan monitoring, risk management, and recovery procedures. Timely intervention, strengthened governance, and prudent lending practices can help tackle this challenge and safeguard the stability of the financial system.

Keywords: Non-performing loans, Bank stability, Finance.

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Introduction

Non-performing loans (NPLs) have become a pressing issue in the realm of finance, exerting profound implications on both lenders and the overall economy. NPLs refer to loans where borrowers have failed to meet their scheduled interest or principal repayments for a specified period, typically 90 days or more. These loans pose significant risks, as they can lead to financial instability and hinder economic growth.

When banks lend a loan, the risk should be assessed and the consequence Non-Performing loans are widely associated with bank failure as well as financial crises for commercial banks. Because of the nature of their business, commercial banks reveal themselves to the risks of default from borrowers. The destruction of

NPLs is a necessary condition to improve the economic status and stability of the banking sector.

Consequently, having more non-performing loans in the company's balance sheet hurts the bank's cash flows, its stock price too. [1] Banks take action to enforce the recovery of non-performing loans in their books in order to return the loans they are owed.

One of the actions that banks try to minimize the risk is to take possession of assets pledged as collateral for the loan. It could be movable and immovable properties. Movable properties refer to things that can be moved such as jewelry, car, equipment and etc. Immovable properties refer to things that are fixed and cannot be moved such as land, real estate etc. [2]

Liberalization of the financial institutions as well as the regulatory restrictions determine the risky nature of the banking firms. According to [3] decisions on extending bank credit claimed that banks are the foundation of “personal contacts and social pressure” that cause inefficiency regarding risk management and NPLs associated problems.

Consumer lending is an opportunity to get a certain amount to solve short-term problems. It is suitable, for example, for purchasing new household appliances, paying for a vacation trip, investing in repairs or furniture. A loan is taken if there are not enough own funds, but in the future, it is easy to pay it back in small monthly payments. To receive it, you must provide a standard set of documents for the bank.

There are two types of consumer credit: without collateral and with the provision of any property to the bank as collateral, i.e., a secured loan. A secured loan will help you out if for some reason you are denied a regular loan. In this case, you can get a loan secured by any movable and immovable property: apartments, houses, commercial premises, parking spaces, land, equipment, etc. This is one of the varieties of secured loans.

According to the James Chen report [4], He mentions, "bank-owned properties that are offered for sale tend to have low-interest rates and low-down payments. The new home buyers and investors can find listings of bank-owned properties through the online service or directly through lenders." But in Azerbaijan in practice, online selling can be after the bankruptcy of the bank. The regulator institutions like Deposit Insurance Funds control the properties after the liquidation of any Bank. The Azerbaijan Deposit Insurance Fund (ADIF) is auctioning the properties on the balance sheets of a number of banks, of which it is the liquidator. [5] The purpose of the creation of the Deposit Insurance Fund is to prevent the risk of loss of funds deposited from individuals when local branches of banks and foreign banks lose their ability to pay, and to ensure the stability and development of the financial and banking system in the Republic of Azerbaijan. [6]

Also, not only the bank can hold such properties it might be a credit union, or other

financial institution offering loan services, such as mortgages. In any case, if the borrower fails to make their mortgage payments or the obligation of the agreement the property is auctioned off. If a property fails to sell at a foreclosure auction it is transferred to the bank and the bank becomes the new owner of the property.

Materials and Methods

Non-performing loans (NPLs) are loans that are in default or are close to being in default. Managing NPLs is important for banks and financial institutions because they can have a significant impact on the financial health of these organizations. Here are some methods of managing non-performing loans: [7]

- **Restructuring:** This involves modifying the terms of the loan to make it more manageable for the borrower. Restructuring can include changing the interest rate, extending the repayment period, or reducing the principal amount. Restructuring refers to the process of modifying the terms and conditions of a loan agreement to provide relief to the borrower who is having difficulty in repaying the loan. This is usually done to prevent the loan from becoming a non-performing asset (NPA) and to help the borrower get back on track with their repayments.
- **Recovery:** This involves taking legal action against the borrower to recover the outstanding loan amount. Recovery methods can include seizing assets or taking legal action against the borrower. Loan recovery refers to the process of collecting the outstanding loan amount from a borrower who has defaulted on their loan payments or has become a non-performing asset (NPA).
- **Write-off:** This involves accepting that the loan is unlikely to be repaid and removing it from the balance sheet. [8] Write-offs can help banks to clean up their balance sheets and improve their financial health. Writing off a loan refers to the process of removing a non-performing loan (NPL) from a bank or financial institution's balance sheet and recognizing it as a loss. This is done when the lender determines that the loan is unlikely to be repaid and there is

little or no hope of recovering the outstanding amount from the borrower.

When a loan is written off, the lender acknowledges that the loan is a bad debt and removes it from their books. This can help to clean up the lender's balance sheet and improve their financial health. However, it also means that the lender has to bear the loss of the outstanding amount.

It is important to note that writing off a loan is a last resort measure and is only done after all other avenues of loan recovery have been exhausted. Lenders typically have strict policies and procedures in place for determining when a loan should be written off and how the loss should be recognized in their financial statements.

- **Loan sales:** This involves selling the non-performing loan to a third party at a discount. Loan sales can help banks to recover some of the outstanding loan amount and reduce their exposure to bad loans.

The sale of NPLs can have benefits for both the seller and the buyer. For the seller, it can provide immediate cash flow and reduce their risk exposure. For the buyer, it can provide an opportunity to purchase loans at a discount and potentially earn a profit by recovering more than the purchase price from the borrower.

However, the sale of NPLs can also have negative consequences for borrowers, who may

be subject to more aggressive debt collection efforts by the new creditor. It is important to ensure that the sale of NPLs is conducted in a fair and ethical manner and that the rights of borrowers are protected.

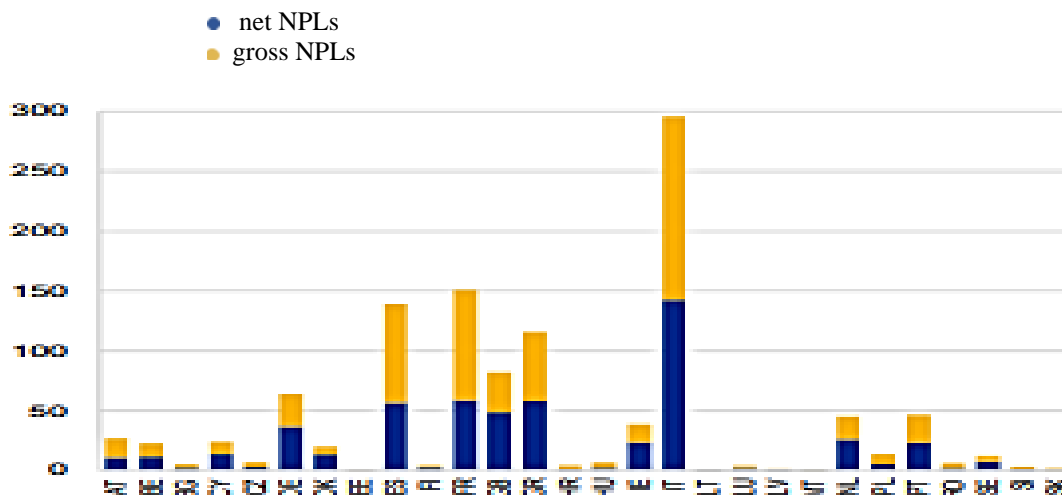
- **Loan provisioning:** This involves setting aside reserves to cover potential losses from non-performing loans. Loan provisioning can help banks to mitigate the impact of non-performing loans on their financial statements. Loan provisioning for non-performing loans (NPLs) is the process of setting aside funds by banks and financial institutions to cover the potential losses from loans that are in default or are at high risk of default. [9]

Analysis and Evaluation

The application of the NPL concept is currently not completely harmonized across countries and banks. There is currently a recognized difference in how the concept is applied in practice across various different countries and even across the various banks within the same country. The coordinated work currently being undertaken by national and European supervisory teams and the entry into force in 2021 of the European Banking Authority's further guidelines on the application of the concept of default should gradually help to improve harmonization. [10]

Chart 1.

The gross loan amount of NPLs in the EU



Source: ECB Consolidated Banking Data and ESRB Secretariat calculations.

According to European Central Bank (ECB) Consolidated Banking Data and European Systemic Risk Board (ESRB) Secretariat calculations, the gross loan amount of NPLs in the EU at the end of the 2016 year amounted to approximately €1.0 trillion, at the same time a net loan amount of €560 billion (see Chart 1). As seen the largest stock of NPLs is held by Italian banks, approximately €300 billion in gross terms. Other big countries' banks like French and Spanish banks are the next follower. In addition, at the end of 2016, gross NPLs amounted to 5% of gross loans in the EU. [11]

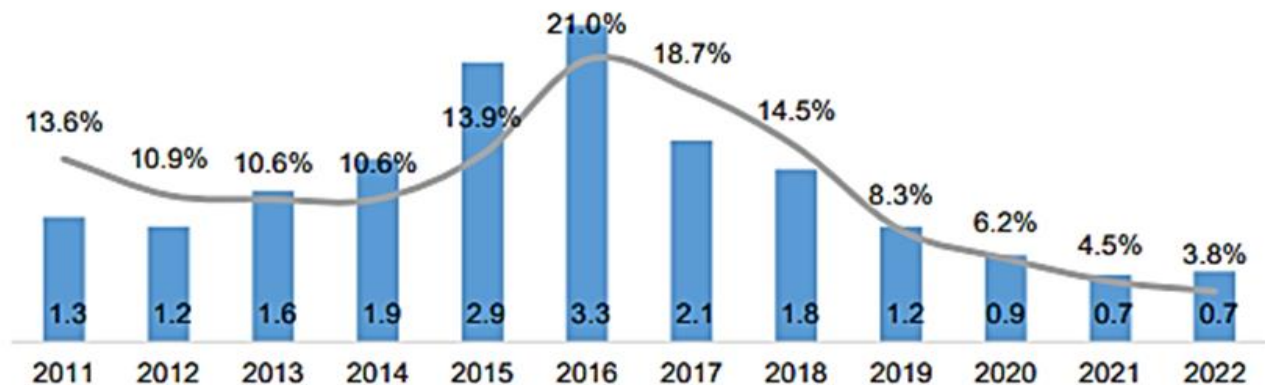
Total reserve levels at top European banks in the Spain, France, and Italy have almost doubled year-on-year, according to Debt wire [12], rising from €35.7 billion in 2019 to €71.8 billion in

2020, as institutions prepare for forecast future losses.

Also, in Azerbaijan management of NPL scale remains uncertain. According the CBAR during the year, the volume of the non-performing portfolio decreased by 1.8% and amounted to 0.7 billion [13]. The share of the non-performing portfolio in the total portfolio decreased by 0.7% to 3.8%. Currently, the NPL ratio is at a historical minimum (Chart 2). The reduction of the NPL portfolio was supported by the improvement of the risk management framework in banks, the positive dynamics in borrowers' payment behavior, and the write-off of problematic assets. Loans in the amount of 180 million manats were written off during the year (in 2021, this indicator was 183 million manats).

Chart 2

The dynamics of NPLs in banking sector



Source: CBAR

Collateral properties in Azerbaijan refer to real estate or other tangible assets that are pledged as security for a loan or other financial transaction. In the context of lending, collateral properties provide lenders with a form of assurance that they can recover their funds in case the borrower defaults on their obligations.

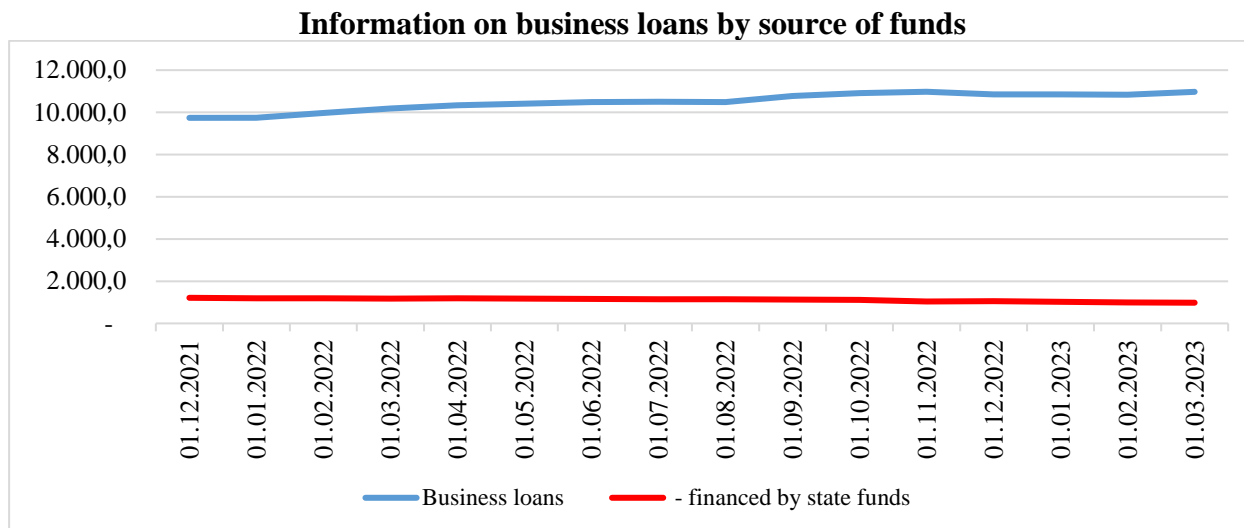
In Azerbaijan, common types of collateral properties can include residential properties (apartments, houses), commercial properties (office buildings, retail spaces, warehouses), and land. These assets are evaluated based on their market value and legal ownership documentation to determine their suitability as collateral.

In the report provided by the Central Bank of Azerbaijan by the year March 2023, the total business loans portfolio has been 10,971.4 million manats. These loans are secured loans, and movable or immovable property can act as security. Usually, banks provide business loans to customers in exchange for liquid real estate when issuing business loans.

As it can be seen, the increase in business loans creates the basis for the classification of these loans as NPLs as a result of any economic downturn in the future and may lead to problems with the properties acting as collateral. As Azerbaijan is still dependent on oil, the change in oil prices has an impact on the economy as

well. At the same time, because of other external influences, the country's economy may lead to economic recession due to political changes.

Chart 3



Source: The Central Bank of the Republic of Azerbaijan

Conclusion

When considering a loan that shows signs of “problem”, it is necessary to find out the causes of their occurrence. For example, a change in the business plans of a corporate client may be caused by a change in the general market situation, which does not allow the borrower to profitably operate in the market segment that is familiar to him. In the event that a deviation in financial reporting indicators is found (for example, a decrease in revenue, an increase in accounts payable and receivable), it is necessary to analyze similar financial indicators for previous years. If the change in financial indicators is associated with the seasonal nature of the business, this does not yet indicate a real deterioration in the financial condition of the borrower as a whole.

At the same time, it should be borne in mind that in some cases these signs may have another interpretation (different from the problematic one). Signs of the borrower's financial troubles, from the point of view of a loan officer, are:

- misappropriation of credit;
- drop in loan turnover;
- cumulative lending (on-lending);
- receipt of negative information about the

borrower from the bank's economic protection service;

- business partners;
- other banks;
- moral and physical aging of collateral, deterioration of the financial condition of the guarantor or guarantor of the borrower;
- delay or incomplete payment of interest for the use of provided credit funds, etc.

These factors help Banks to manage their NPLs portfolio. In this article, we show key factors and others countries approaches' to NPLs portfolios.

Proposal

Practically, the solution to the problem of overdue debt management in banks largely depends on two conditions:

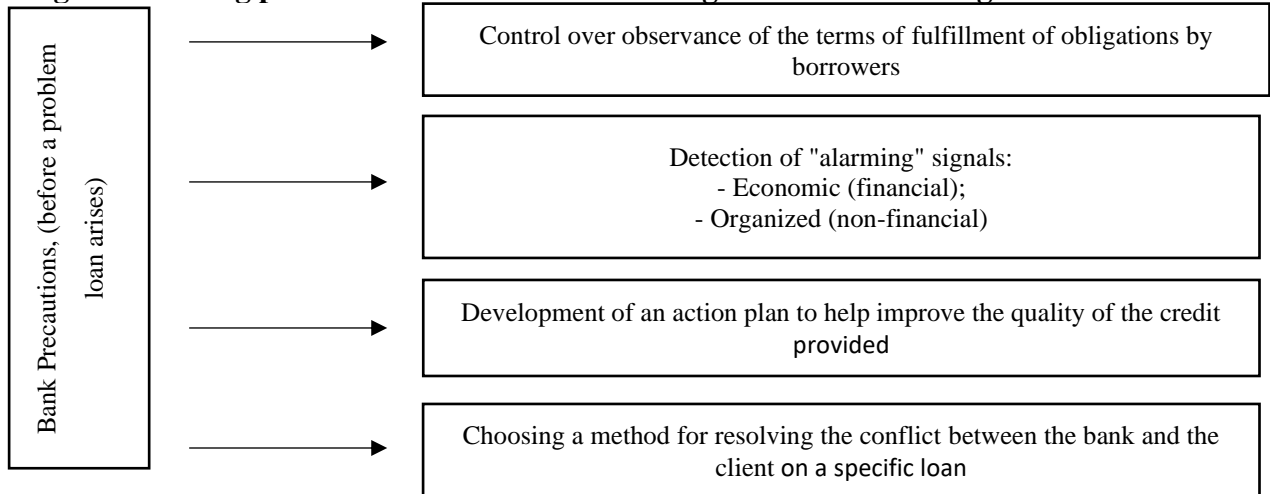
Firstly, does the loan agreement contain provisions that give the bank the right to check the borrower's accounting and financial statements by conducting inspections directly at the enterprise, and is it possible to terminate the loan agreement and foreclose on collateral if the bank has reasonable suspicions about the insolvency of the borrower.

Secondly, what powers are vested in the loan officer of the bank, under the constant control of which each loan issued should be.

The stages of banking practice in the field of monitoring concluded loan agreements can be presented in general terms. (Chart 5)

Chart 5

Stages of banking practice in the field of monitoring concluded credit agreements



Stages of banking practice in the field of monitoring concluded credit agreements

It should be noted that the first and second stages involve measures applied to ordinary loans, while the third and fourth ones already apply to risky ones.

Regardless of whether the signs of a “problem” loan are financial or non-financial, the responsible loan officer should take the following measures to develop an action plan to improve the quality of the loan:

- conduct a full analysis of the financial security of the borrower's loan and draw up a conclusion;
- to collect complete information on the areas in which the bank's work with this borrower is at risk;
- daily control the receipt of funds at the expense of the borrower and, in the event of a prolonged absence of receipts of funds to the current (currency) account, require an explanation of the reasons;
- check the correctness of the legal execution of all loan documentation, especially the documentation for securing the return of the loan;
- explore the possibility of obtaining collateral in the event that the loan is not secured.

Problem loans are most often the result of a financial crisis in a client, and this crisis may appear suddenly, but it develops gradually. And as it develops, even weaker, but still signs (external and internal) of its onset begin to appear. Employees of the credit division are the first "line of defense" of the bank against possible losses.

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СОВЕРШЕНСТВОВАНИЕ УПРАВЛЕНИЯ ПРОДАЖЕЙ ИМУЩЕСТВА, НАХОДЯЩЕГОСЯ НА БАЛАНСЕ БАНКА, А ТАКЖЕ ПРОБЛЕМНЫМИ КРЕДИТАМИ

Аннотация: В исследовании использовались переменные банковской системы Азербайджана и экономики Азербайджана, для улучшения управления просроченными кредитами и продажей имущества на балансе банка.

Проблемные кредиты (NPL) стали серьезной проблемой в мировой финансовой среде. Эти ссуды относятся к тем, по которым заемщики не внесли запланированные проценты или погашение основной суммы долга в течение определенного периода, часто 90 дней или более. Неработающие кредиты представляют собой риски как для финансовых учреждений, так и для экономики в целом, поэтому крайне важно понять их влияние и найти эффективные решения.

Неработающие кредиты создают массу проблем для банков и финансовых учреждений. В случае дефолта заемщиков кредиторы сталкиваются со снижением прибыльности, нехваткой ликвидности и повышением требований к резервированию. Возникающая в результате эрозия капитала может ослабить стабильность финансовой системы. Кроме того, проблемные кредиты препятствуют способности банков кредитовать производственный сектор, подавляя экономический рост.

Причины неработающих кредитов многогранны, включая экономический спад, слабое управление рисками и неадекватные стандарты андеррайтинга. Эффективная оценка рисков, раннее выявление проблемных кредитов и упреждающая реструктуризация кредитов имеют решающее значение для смягчения последствий неработающих кредитов.

Работа с проблемными кредитами имеет жизненно важное значение для обеспечения финансовой стабильности и содействия устойчивому экономическому росту. Правительства, регулирующие органы и финансовые учреждения должны сотрудничать для разработки надежных основ для мониторинга кредитов, управления рисками и процедур взыскания. Своевременное вмешательство, усиление управления и осмотрительная практика кредитования могут помочь решить эту проблему и обеспечить стабильность финансовой системы.

Ключевые слова: Проблемные кредиты, Банковская устойчивость, Финансы.

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QEYRI-İŞLƏK KREDİTLƏRİN VƏ BANKIN BALANSINDA OLAN ƏMLAKLARIN SATIŞININ İDARƏ EDİLMƏSİNİN TƏKMİNLƏŞDİRİLMƏSİ

Xülasə: Tədqiqatda Azərbaycan Bank Sisteminin və Azərbaycan iqtisadiyyatının dəyişənlərindən, Qeyri-İşlək Kreditlərin (QİK) idarə edilməsini və Bankın balansında olan əmlakların satışını təkmilləşdirmək üçün istifadə edilmişdir.

Qeyri-İşlək kreditlər (QPL) qlobal maliyyə mənzərəsində əhəmiyyətli bir narahatlıq kimi ortaya çıxdı. Bu kreditlər borcalanların müəyyən bir müddət ərzində, çox vaxt 90 gün və ya daha çox müddətdə planlaşdırılmış faizləri və ya əsas borcunu ödəmədiyi kreditlərə aiddir. QİK-lər həm maliyyə institutları, həm də ümumi iqtisadiyyat üçün risklər yaradır, bu da onların təsirini başa düşməyi və effektiv həllər tapmağı vacib edir.

Qeyri-İşlək kreditlər banklar və maliyyə institutları üçün bir sıra problemlər yaradır. Borcalanlar defolt etdikdə, kreditorlar aşağı gəlirlilik, gərgin likvidlik və artan ehtiyat tələbləri ilə üzləşirlər. Nəticədə kapitalın aşınması maliyyə sisteminin sabitliyini zəiflədə bilər. Bundan əlavə, QİK-lər bankların məhsuldar sektorlara kredit vermək qabiliyyətinə mane olur, iqtisadi artımı boğur.

Qeyri-İşlək kreditlərin arxasında iqtisadi tənəzzüllər, zəif risklərin idarə edilməsi və qeyri-adekvat anderrayting standartları da daxil olmaqla çoxşaxəli səbəblər var. Effektiv risklərin qiymətləndirilməsi, problemlı kreditlərin erkən aşkarlanması və kreditlərin proaktiv restrukturizasiyası QİK-lərin təsirini azaltmaq üçün mühüm əhəmiyyət kəsb edir.

Qeyri-İşlək kreditlərin həlli maliyyə sabitliyini təmin etmək və davamlı iqtisadi artımı təşviq etmək üçün çox vacibdir. Hökumətlər, tənzimləyicilər və maliyyə institutları kreditlərin monitorinqi, risklərin idarə edilməsi və bərpa prosedurları üçün möhkəm çərçivələr hazırlamaq üçün əməkdaşlıq etməlidirlər. Vaxtında müdaxilə, gücləndirilmiş idarəetmə və ehtiyatlı kreditləşmə təcrübələri bu problemin öhdəsindən gəlməyə və maliyyə sisteminin sabitliyini qorumağa kömək edə bilər.

Açar sözlər: Qeyri-İşlək kreditlər, Bank sabitliyi, Maliyyə.

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