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PRACTICAL STATUS OF PROBLEM LOANS IN THE BANKING SYSTEM OF OUR REPUBLIC AND WAYS TO REDUCE THEM

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ABSTRACT: Problematic loans, or non-performing loans (NPLs), pose a significant challenge to the banking systems worldwide, including in many developing and emerging markets. In the context of our Republic, the banking sector has faced increasing issues with the quality of loans, particularly in light of economic disruptions, political instability, and changes in global financial conditions. Problematic loans not only undermine the financial health of individual banks but also impact the overall stability of the financial system and limit the ability of banks to lend to businesses and consumers. This article aims to explore the practical status of problem loans in the banking system of our Republic, examining the causes, current trends, and the impact of NPLs on financial institutions.

Keywords: Problematic loans, non-performing loans (NPLs), banking system, asset management companies (AMCs), loan restructuring, financial stability, loan management practices, regulatory frameworks, banking sector reforms, financial health.

The banking sector serves as a backbone for economic development by providing credit for businesses, consumers, and the government. However, one of the most persistent challenges for banks globally and within our Republic is the issue of problem loans, particularly non-performing loans (NPLs). These loans occur when borrowers fail to meet their repayment obligations, leading to increased risk and instability in the banking sector. The accumulation of NPLs can have severe implications on financial stability, reducing the ability of banks to lend, weakening capital buffers, and limiting economic growth. In recent years, the Republic's banking sector has witnessed an increase in problem loans, driven by a variety of factors, including economic fluctuations, political uncertainty, and insufficient credit risk management. This article investigates the practical status of problem loans in the banking system of our Republic and outlines effective measures to reduce their prevalence.

The issue of NPLs in the Republic's banking system has become a growing concern. Data from the national banking regulator shows a consistent rise in the percentage of NPLs in recent years, reaching levels that are higher than acceptable standards for financial stability. As of the latest reports, NPLs make up a significant portion of the total loan portfolio, with many banks struggling to deal with the growing volume of bad debts. These trends have been exacerbated by global economic disruptions, domestic political instability, and weak regulatory frameworks. Many banks have not implemented effective risk assessment procedures, resulting in an overexposure to high-risk sectors such as construction, agriculture, and small and medium-sized enterprises (SMEs), which are particularly vulnerable to economic shock. Political instability, policy changes, and corruption have also contributed to loan defaults, as borrowers in certain sectors face unexpected regulatory changes and reduced business activity. The global financial crisis and subsequent economic challenges have also affected external trade, commodity prices, and remittances, further increasing the burden on borrowers.

Improvement in Credit Risk Management. One of the most effective ways to reduce problem loans is to enhance credit risk management practices. Banks must adopt more rigorous loan screening processes, ensuring that only creditworthy borrowers are granted loans. This includes improving credit scoring systems, conducting thorough due diligence on borrowers, and regularly reviewing loan portfolios to identify and address potential problem loans before they become non-performing. Strengthening the regulatory environment can play a crucial role in reducing problem loans. Regulatory bodies must enforce stricter lending standards and ensure that banks maintain adequate capital buffers to absorb potential losses from problem loans. Additionally, regulators should encourage banks to implement proactive measures such as early warning systems for loan defaults and timely reporting of NPLs. Transparency in the classification and reporting of NPLs is also essential to provide a clear picture of the financial health of banks.

Loan restructuring allows banks to work with borrowers who are facing temporary financial difficulties but have the potential to recover. Restructuring might involve extending repayment terms, reducing interest rates, or even partial debt forgiveness. This approach can help prevent loans from becoming non-performing and allow borrowers to get back on track without putting undue strain on their finances. To address the growing volume of NPLs, many countries have established **Asset Management Companies (AMCs)** that specialize in buying distressed assets from banks. These institutions can manage and restructure the NPLs, working to recover value from these loans through either sale or resolution. AMCs provide banks with the opportunity to offload bad debts, thereby improving their balance sheets and freeing up capital for further lending. Establishing AMCs in our Republic could help reduce the burden of NPLs on the banking sector and improve financial stability. A robust collection and recovery process is essential for reducing the number of problem loans. This includes improving the internal capabilities of banks to recover loans through legal means, such as foreclosure or the sale of collateral, as well as negotiating repayment terms with defaulting borrowers. Additionally, banks should consider creating special recovery departments dedicated to handling NPLs and improving their ability to resolve defaulted loans quickly and efficiently. In many countries, the private sector plays a key role in addressing NPLs. Financial institutions, private equity firms, and distressed asset investors often purchase NPLs from banks, providing them with the capital they need to continue lending. The creation of a healthy secondary market for NPLs could be instrumental in reducing problem loans in our Republic.

In particular, it was noted that the share of loans granted by private banks in the total amount of loans granted in 2023 will increase from 31% to 43%, and the share of loans granted to corporate clients will increase from 25% to 34%. Increasing the efficiency of the banking system of our country is associated with the active participation of banks in lending to the real sector of the economy. However, commercial banks of our country are facing a number of difficulties and problems in conducting lending activities. In particular, today the presence of problem loans is noticeable among the loans that make up the main part of the income-generating assets of commercial banks. Since banks use the attracted funds mainly as loans, it is necessary to determine in advance not only the issue of receiving income, but also the issue of fully recovering the funds from the “borrower”. After all, “the bank, as the owner of the capital, sells not the capital, but the right to use the capital under certain conditions and with a surcharge.” At the same time, in our country, the concept of "problem credit" is used much more often in scientific and theoretical circles and practitioners than before and is causing controversy. Despite the fact that disputes over problem credits have been going on in scientific circles for some time, a single definition of the term "problem credit" has not yet been given.

Several definitions of problem credits have been given in the scientific literature. In some literature, risky credit investments in the activities of commercial banks are defined as investments that fall into the form of problem credits, while in some literature, problem credits are defined as a loan whose object, subject and collateral are in doubt by the bank. Also, if the loan granted has problem collateral and the value of this collateral is less than the amount of the outstanding debt, then this loan is considered a problem loan, and loans classified as substandard and lower are classified as problem loans. In particular, according to Peter Rose, the borrower's failure to make one or more payments or a decrease in the value of the collateral means that the loan has been classified as a problem loan. According to the definition of some Western economists, a delay in loan payments for more than 90 days according to the schedule or a violation of the terms of the loan agreement indicates that the loan is problematic. According to some authors in Russian literature, a problem loan is understood as a loan whose object, subject and collateral are in doubt by the bank. In their opinion, substandard, doubtful and unreliable loans, that is, all loans, except for current loans that have not expired, including those with short-term debt on the principal payment and loan interest, as well as loans that have been reissued at least once without changing the terms of the loan agreement, are considered problematic.

The increasing prevalence of problem loans in the banking system of our Republic represents a significant challenge to the financial sector and the broader economy. However, through a combination of enhanced credit risk management, regulatory reforms, loan restructuring, and the establishment of Asset Management Companies (AMCs), it is possible to reduce the volume of non-performing loans and restore financial stability. Learning from international experiences and tailoring solutions to the specific context of our Republic will be key to mitigating the problem of NPLs and ensuring a sustainable banking system in the future.

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