

INFLUENCE OF THE FINANCIAL CRISIS ON THE CREDIT POLICY OF BANKS FROM THE REPUBLIC OF MOLDOVA

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Abstract

Find out about the situation when the potential consequences of the global financial crisis, which can have a negative impact on the national economy, other economic and political causes, both external and internal, impose the need to take additional measures to effectively manage of the credit risk of domestic banks, are guided by the principle of a credit policy with the maximum caution to granting the new loans, applying tougher criteria for selecting potential customers.

Thus, its importance was felt especially when faced with the financial crisis, the bankers realized that maintaining the profitability of its credit portfolios is only possible through the implementation of an efficient and receptive credit policy to market trends.

Key words: *credit policy, financial crisis, the quality of the loan portfolio, profitability, lending activity, stability of the banking system*

JEL CLASSIFICATION: G21

Introduction. The period when the negative effects of the financial crisis are felt makes it necessary for the banking system to fundamentally restructure, both from the point of view of the strategies and the policies it determines.

Current economic development conditions of banks require the existence of well-organized policies and strategies, determined by applying the specific techniques and managerial tools that are characteristic of the local economy in the situation of the global financial crisis.

A major contribution to banking profitability is the quality of the loan portfolio, which is closely related to the credit policy applied by the bank which, through specific strategies, must respond to the bank's principles and objectives and in crisis situations to provide efficient solutions of overcoming the future weather and deficiencies.

The global financial crisis has created headaches especially for banks, the financial situation that suddenly worsened and was reflected in their financial indicators, suffered from their ratings, credibility and their names, but for some banks that could not keep their chest this being also the reason for the insolvency recently declared.

Thus, year after year and especially now, in the crisis, banks tend to increase the profitability of their credit portfolios, improve their quality and diminution their risks in order to achieve good incomes and stable financial indicators, but to reach the proposed goals of combining aspirations with risks to achieve the desired results is not so simple. An effective solution for improving the profitability of the credit portfolio and without which it would not be possible to carry out credit activity within banks is the credit policy that requires a systematized adjustment to market trends in order to prevent future failures, which implies a huge thing but without which we will never be able to turn potentially negative results into opportunities.

The skill of correlating goals safely has to be found in the lending activity of banks. Analysis of banks' credit portfolio quality demonstrates a direct link between the bank's credit policy and the profitability of the loan portfolio, but above all the effectiveness of a "healthy" credit policy on banks' core indicators.

The essence and determinants of credit policy. The dependence of the profitability of credit portfolio's by the credit policy of the bank determines that the most senior minds of the top management will be concentrated on its development, given that the standards and regulations imposed by it and subsequently determines the performances reflected in the financial indicators periodically calculated by the bank, which creates its reputation and rationality [1].

From the point of view of the management of the portfolio of held loans, its primary purpose is the quality of the portfolio, but the crisis involves disturbances from one credit policy to another and implies the existence of strong imbalances in its structure created by the financial instability of the borrowers of the bank.

From the great diversity of the problems we face, one of the most actual in a financial institution that aims to develop with fast and secure steps are the customers who forget about the previously assumed bonds, namely they are constituting the much-wanted target of neutralizing or minimizing of all managers to initiate credit policies that are aimed to improving the quality of their credit portfolio.

The way how the bank allocates the funds that it manages determines in particular its financial results. On the other hand, any bank assumes certain risks when granting loans and certainly signs losses on the loan portfolio when some debtors do not honor their obligations. From this point of view, the most important function of corporate banking governance is to manage prudently the quality of the loan portfolio, for ensuring the stability and development of the bank. And the result of these actions depends largely on the environment in which the bank operates.

Credit policy sets out the objectives and priorities of the bank's credit activity, its means and methods of realization, as well as the principles and methodology of the crediting process. Credit policy creates the basis for the bank's crediting process in line with its development strategy and its activity is a necessary condition for elaborating the procedures and standards that governed the credit process.

Credit policy is the bank's strategy and tactics in the field of credit activity elaborated in accordance with the regulations in force [2].

Credit policy serves to define bank standards and organizational objectives, lending activity, covering technical and credit portfolio issues.

To overcome credit deficiencies related to the lending activity, banks need to develop well-founded lending policies to hire or prepare credit officers who understand and accept credit policy discipline.

Elaborated and approved by the bank management, it follows to be brought to the attention of all subdivisions involved in the lending process in order to ensure the efficient functioning of the credit risk management in order to streamline the lending activity of the bank.

The elaboration and improvement of the credit policy is in the competence of the directors and the superior management of the bank. They are also responsible for the development of credit culture in the bank and the fulfillment of lending goals. Due to this fact, the credit policy besides determining the basic rules and the directions of the credit activity, contributes to the formation of the credit culture.

Credit policy is elaborated in line with the bank's strategy and risk management policy. It determines the following directions of credit activity:

- standards and criteria for the people involved in the lending process;
- the decision-making powers in the lending process, which are mainly led by the superior management of the bank;
- principles for monitoring the quality of the credit portfolio of the bank and the internal and external audit of the bank.

Credit policy is necessary to ensure the continuity and diversification of banks' activity; the delegation of competencies and the establishment of the core obligations of credit specialists. In the absence of credit policy and steps to achieve it, it would not be possible to implement in practice the

unique credit rules that will be followed by all bank employees. That is why the credit policy and the corresponding performance rules follow to be written in writing form and provide the foundation of the credit process. If we were lead by an ideal scenario, the elaboration of credit policy, its standards, instructions and norms is the responsibility of the Credit Committee established by the Bank Board.

The credit policy is based on the professionalism of bankers who need to choose correctly and reasonably:

- the economy sector that is going to be credited at the moment depending on the market evolution;
- the already existing customer based out on its debt service capability and other important factors.

Thus, are set the main prerogatives and priorities in the decision making of the allocation of the crediting means. Credit policy is also determined by the credit products available to the bank today and to be settled tomorrow. For example, these may include short-term credits (to finance current operational activity) and long-term loans (for modernization, expansion of activity, re-engineering or implementation of technical-scientific technologies).

A determinant element in the credit policy is the organization of control and supervision within the bank (the management of credit standards in the decision making process of the potential client, the control over the respect of skills by banking employees, the overall control over the quality of the loan portfolio of the bank and, in particular, of problematic loans).

Credit policy determines the core direction of credit activity. It could be treated as a system for achieving the adopted directions of credit policy. Credit policy must reveal the following basic elements [3]:

- organizing lending activity;
- management of the credit portfolio;
- credit control;
- principles of competence determination;
- general criteria for selecting credits;
- limits on separate credit lines;
- principles of credit monitoring;
- formation of the risk fund.

Analysis of the credit policy of banks in the Republic of Moldova. Thus, the stability of the banking system in the Republic of Moldova, which has been built over several years due to such factors as banks' prudent risk management, improving the quality of banking management, increasing foreign investment in the sector, was currently threatened by the risks induced by the problems with which are faced some branches of the real sector of the economy in the period of the economic decline. And here we refer to the main banking risk - the credit risk, also called the risk of deteriorating the quality of banking assets.

According to NBM data, the quality of the credit portfolio on the domestic banking system from 31 December 2016 has worsened. The share of non-performing loans (substandard, dubious and compromised) in the total regulatory capital was increased by 4.5 percentage points in comparison with 19.5%. And the share of non performing loans in total loans increased by 6.4 percentage points as compared to the end of 2015, being 16.3% at 31 December 2016.

However, under the current economic conditions, banks are becoming more restrictive in providing new loans. So, in conclusion, the stability of the domestic banking sector is in close dependence and interference with the situation in the real sector of the national economy. Of course, in this context, it is natural to ask what factors have led to the withdrawal of the main indicators of the banking system in our country in recent years? Undoubtedly, the explanation is one - the virus of the global financial crisis that affected the Moldovan economy, implying the rebound of

economic activities, the reduction of consumption, the volume of remittances, the compression of credit.

Impact of the crisis on credit activity of commercial banks in the Republic of Moldova. By analyzing the lending activity of commercial banks in the Republic of Moldova during the period of 2013-2016, we can observe with “unapproved eye” the effects of the global crisis.

Table 1. The evolution of the quality indicators of the loan portfolio in Moldova during the years 2013 – 2016

Indicators		2013	2014	2015	2016
Debt balance on loans	mil. lei	42 170,70	40 841,98	38 186,61	34 761,27
Debt balance on non-performing loans	mil. lei	4 876,44	4 790,34	3 798,58	5 702,64
Debt balance on non-performing loans / CNT	%	59,70	53,14	40,69	59,08
Debt balance on non-performing loans / Debt balance on loans	%	11,56	11,73	9,95	16,41
Total expired credits	mil. lei	4 393,15	4 862,16	3 310,95	4 721,47

Source: prepared by the author based on reports of Financial indicators on the banking system of the Republic of Moldova. [online]. Available: http://nbm.md/md/financial_indices_of_bank_system_md.

The gross loan portfolio constituted 34 761.3 million lei, decreasing by 7409.43 million lei (17.6%) over the analyzed period. The decrease in the gross loan portfolio was mainly caused by the lack of demand for loans, as well as by the more prudent approach applied by banks to potential borrowers.

At the same time, the share of GDP in gross loans decreased from 31.2% on 31 December 2015 to 25.8% at 31 December 2016.

In terms of branch distribution, the largest share in the total loan portfolio was held by credits granted to commerce - 29.6%, followed by loans granted to the food industry - 10.1%, consumer credits - 9.6%, credits to agriculture - 7.4% , loans granted to the productive industry - 7.3%, loans for building / building construction - 6.6%, loans granted in the field of services - 6.5%, etc.

The structure of the credit portfolio by branches of the economy has undergone major changes in the last years, obviously from the chart presented in Table 2. Thus, the share of credits granted to trade is 29.58% at the end of the previous year, which represents a decrease of more than 10 percentage points compared to 2013.

Analyzing the evolution of the different weight we observe an increase in the value of consumer loans and a decrease in loans for real estate, construction and development and consumer loans, with at least two causes:

- or the modification of the request in time for these credits,
- or commercial banks want a limitation of some and the expansion of other types of loans.

I think it would be more just the first cause, because are known the problems that are recorded by the commercial banks with the credit of construction companies, which in turn have serious problems with the realization of the built-up areas. Thus, the fall in demand for real estate has a direct proportional effect on falling demand for real estate, construction and development loans, and consumer credit.

The crisis also affects the quality of the commercial banks' loan portfolio. Due to the decrease in the volume of money transfers made by the population leaving abroad and the decrease of the incomes of the population inside the country, the sales of the economic agents also decreased. The debtors of the bank, being the same individual persons or economic agents, because they are registered financial problems, require commercial banks to form for their granted loans - higher reserves, namely:

The impact of the crisis on the quality of the loan portfolio are presented and by the ratio between the reduction for loan losses and total loans that on 31.12.08 was amounted of 4.85% with a steady increase in the following years, reaching at the end of 2016 13.42%.

The average interest rate on loans granted in 2016 constituted 14.20% in national currency and 5.90% in foreign currency.

During the year 2016, 84% from the total volume of credits are granted to legal entities: residents (31.2 billion lei) and non-residents (370.8 million lei). The balance of credits to individuals exceeds 6 billion lei, 99.9% of them being granted to individual residents.

The significant losses generated by the credit market crisis have determined the banking system to examine the introduction of new rules for reporting banks' exposure indicators to risk for reorienting their credit policies and find solutions to offset the negative effects of the financial crisis.

Thus, if until the financial crisis the banks' credit policy was primarily oriented to the sale of existing credit products and the promotion of some new ones on the market then now banks are fighting each day with problematic debtors who are nothing than the result of credit policy which has been leading credit specialists for a long time. Among its basic principles we can list:

- lighter standards for loan approval;
- a significant increase in credit incentives, such as advantageous initial terms;
- a long-term trend in the price of goods.

Like any crisis, the one we face today has lessons to learn and provides a list of tasks for legislators. Two of the most important challenges are transparency and liquidity. There is also pressure to impose more effective accounting. As things are stand today, the credit policy of the bank is currently concerned with:

- developing new working strategies with problematic credits;
- introducing more strong prudential requirements;
- developing an extensive regulatory framework that will include a better risk reporting methodology and a review of the calculation of the value of financial assets;
- developing schemes for moving liquidity surplus from those who save money to those who need more resources (for consumption or for investment) to help their borrowers avoid subsequent arrears on loans;
- keeping an interest rate (covering various horizons of time) that would reconcile the desire of some to borrow with the inclination of others to give up form a part of their own resources over a period of time;
- developing new (prudential) effective surveillance mechanisms to avoid major failures and large-scale turbulence.

In addition, each bank has specific loopholes to its credit policy that require a different approach depending on the bank's financial situation and can not be the same for the entire banking system.

There are also loopholes for all banks, so in many ways, the classic risk assessment methods used so far in the banking system have become obsolete. Today, the complexity of the available instruments on the banking market shows that these methods are unreliable. Quantitative methods, often used in investment decision making and risk assessment in banking markets, inherently have an intrinsic conceptual error. However, the risk can not be reduced to a few numbers, so a much more comprehensive description is needed.

Probably the biggest task the bankers have to deal with is to combat the spread of large systemic risks when banking innovations are growing.

CONCLUSIONS

Concluding on the credit policy developed in the banks of the Republic of Moldova, we will look for its prime place in the financing of the economic agents taking into account the results of the evaluation. For these reasons, the following directions for improving the credit policy are proposed:

- In order to increase the net profit of commercial banks, improve the quality of the credit portfolio, diversify assets and select the most credible banking clients, it is necessary to interlink the objectives of the lending policy with those of the evaluation activity;
- Concurrently conducting the credit process and valuation processes in line with international requirements to reduce the volume of problematic loans and strengthen the Bank's options on financing the bank customers;
- Strengthening the credit discipline by permanently monitoring the bank's activity, including the lending process, and by improving the legal basis of the deposit and assessment mechanism of the pledge;
- Continuous monitoring of credit insurance and repayment guarantees;
- Reviewing the methodology for the valuation and trading of pledges in commercial banks' pledge valuation departments;
- Revision of commercial bank lending policy through the dispersion of credit portfolio risk and interest rate setting, taking into account the principle of banking prudence;
- Conducting the diagnostic-analysis of the financial condition of the economic agents in order to determine the credibility, using unique databases by groups of clients and by sectors of the economy;
- Analyzing the credibility of bank customers by using computerized and documentary databases to ensure the accuracy of information and their appropriate classification by risk groups and by branches of the economy.

In order to streamline the loan portfolio, it would be appropriate to review the lending policy on credit remittances and credit risk mitigation, which would improve the situation on problematic loans and help to improve the credit facility of payments between customers and bank.

From this point of view, it is necessary to review the lending banking strategies, including several ways of repaying credits, more efficient ways to assess the credibility of bank customers.

A major concern of commercial banks in this context is the limitation and diversification of credit risk, which in turn influences the quality of the loan portfolio.

If we were to elucidate the problems and causes of the deterioration of the quality of the bank's loan portfolio then we should start from the fact that at the basis of all the actions of the financial institutions are primarily the laws, regulations and normative acts in force. Respectively and all banks' standards, regulations, procedures and norms are primarily based on the legislation of the Republic of Moldova. However, the legislative base is not perfect and contains various loopholes the task of credit policy is first of all to identify these gaps and to suppress them through the standards and procedures developed by it. This is not always so easy to accomplish given the fact that in a department have always been different views on the same things, and it is not always possible to find the "golden mean" in solving some problems, hence the subsequent gaps in standards and the elaborated procedures imposed by a bank's credit policy, which often become causes of the credit portfolio's quality deterioration.

Another reason for the deterioration of the bank's loan portfolio is the staff of the bank, namely the credit officers who are primarily dependent on the quality of the credit portfolio, namely they select the potential clients of the bank and are the first to take the decision to grant the credit, they monitor the credits already granted and follow the financial situation of the bank's debtors; by them depend the client's attitude towards the bank and on the commitments it undertakes with the signing of the credit agreement. It is very important for credit officers to know perfectly the standards, regulations and procedures imposed by the bank's credit policy, to devise the essentials of the bank's strategies and the aspirations it aspires to. However, banks are often concerned with the qualification of their staff not to the extent they should have been, with superior management having as their primary purpose the elaboration of internal rules forgotten by those who lead them and their particularly important role.

One of the main reasons for the deterioration of the quality of the credit portfolio at the moment is the global financial crisis that has begun to beat bankers everywhere. Many of the borrowers with perfect lending histories when faced with the crisis were unable to keep them up, this affected their financial situation and the process of honoring their obligations to the bank.

But guilty of worsening of the credit portfolio quality are not only the bad guys but also the superior management of banks that with the first signs of the financial crisis would change immediately all the strategies and ways to achieve the proposed goals and of course the greatest changes that follow to support the credit policy form which depends a lot the quality of the credit portfolio of any bank.

Find out in the period when the crisis makes you feel all the negative effects: it cuts your income or steals your sources of income in full, the economic agents and individuals also decide to address the bank after loans, this being the moment when the officers credit with a lot of credit requests on their tables and choosing perfect customers is not that simple because you are on the verge of the cliff and the clients become very "ingenious": they use different chips and schemes to get money when you expect it less.

That is why the bank also remembers that it has raised its portfolio with several loans that will give it big beatings and will worsen the quality of its loan portfolio considerably. This was also the time which credit policy must provide in advance in order to determine those filters that will not allow problematic credits to appear in the bank's loan portfolio.

Once granted, the loans are regularly monitored and effective monitoring is the best remedy to maintain a healthy credit portfolio. Done in time and with great care, it allows us to determine the problems faced by the debtors of the bank and helps us to prevent the arrears and the emergence of the infected loans, which in turn can worsen the quality of our loan portfolio. But unfortunately, not all banks are mindful of this imperative factor that often plays the fiesta for them. Easy monitoring is one of the main causes of the bank's credit portfolio worsening.

It is, of course, obvious that a performing credit policy must encompass both programs and credit portfolio management procedures that aim, in fact, to minimize the likelihood of worsening and potential exposure of the bank. We argue that it is obvious because the main objective of these policies is to minimize the losses or additional costs borne by the bank, and the central objective of the banking activity is to obtain a higher profit for the shareholders.

When granting credit, bank always has to bear in mind the principle that the first source of credit repayment is considered the borrower's ability to generate liquidity, and material guarantees must always be the ultimate source of credit repayment and interest payments.

And the first mandatory guarantee of any credit must be the divestiture in favor of the bank of the cash-flow of the economic agent, which will be carried out through accounts opened at the territorial units of the bank.

Against the backdrop of external developments, over the years, credit policy has traditionally been managed and developed in line with market requirements.

At the same time, in order to further the diminishing of the negative effects of the financial crisis and improve the quality of the credit portfolio, the credit policy that is a decisive factor in this process is going to take a series of measures to be taken in order to make it more efficient, which:

- a permanent review of the credits granted, with a view to the early detection of potential bankruptcies;
- reviewing and accentuating prudent lending conditions;
- the existence of a set of policies and strategies aimed at eliminating losses and reducing costs;
- ensuring a high level of internal control;
- the use of extremely restrictive credit policies;
- avoidance of the grouping of credits in the major risk categories;

- determining the portfolio quality trend so that the necessary steps can be taken to avoid a deterioration in quality over time;
- reducing credit maturity and investment portfolio;
- risk spreading through the syndication of large loans with banks and financial institutions;
- insurance against the risks at specialized institutions (insurance and reinsurance companies).

Thus, through a continuous improvement and systematized adaptations to market trends, credit policy will transform into a sure pillar of the profitability and quality of the loan portfolio, which will lead to the establishment of stable financial indicators and the generation of steady-increase.

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