

THE ESSENCE OF CREDIT POLICIES AND METHODS FOR PERFECTING THIS FROM THE PRUDENTIAL PERSPECTIVE

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Abstract

The actuality of the study lies in the role and importance of a lending policy consistent with the changes in the market economy and its ability to adapt to the current economic situation. The purpose of the study is to determine the ways to improve the credit policy of the commercial bank according to the prudential supervision established by the NBM.

Research methods. A systematic approach, historical and economic-statistical methods were used.

The formation of an efficient lending policy, the development of practical mechanisms and tools allow increasing the potential of optimizing its impact on the financial results of a commercial bank in a changing external and internal environment.

Results. Following the research conducted, the structural model of the credit policy was characterized, the scheme of interaction of the elements of the credit policy was determined and the methods for improving the credit policy from the prudential perspective were identified.

Key words: *credit policy, commercial bank, loan portfolio, prudential regulation, credit risk.*

Jel Classification: *G15, G21*

INTRODUCTION

The bank's lending policy represents all the factors, documents and actions that determine the development of the commercial bank in the field of lending. The lending policy determines the goals and priorities of the lending activity of the bank, the means and methods of achieving them, as well as the principles and order of organizing the lending process. It creates the basis of the bank's lending activity in accordance with the general strategy of its activity, being the necessary condition for the elaboration of the system of documents intended to regulate the lending process [1, 2, 3].

The bank's lending policy determines the standards and objective parameters of the bank's functioning in the process of lending and managing the credit risk. In addition, the lending policy allows the assessment of the quality of the loan portfolio and the correct classification of the bank clients by risk groups, thus ensuring the portfolio diversification. It can be said that the basic objectives of the commercial bank's lending policy should include:

- the analysis of the credit market and the establishment of the priority market segments in order to minimize the credit risk;
- maximizing profit in the process of lending and attracting deposits;
- optimizing the management of the bank's loan and deposit portfolio;

- reducing the share of non-performing loans;
- maintaining the bank's liquidity from the loan portfolio management positions.

Each direction of the theoretical model of the formation of the credit policy has a connection with the other directions of activity of the bank and is mandatory for the organization of the lending process. For this, it is necessary to establish the correlation between the elements of the credit policy and the stages of granting the credit as reflected in table 1.

Table 1. Practical expression of the elements of the credit policy

Lending stages	The regulated parameters
1. Preliminary work on the granting of loans	<ul style="list-style-type: none"> - the composition of the future debtors; - types of loans; - the quantitative limits of lending; - standards for evaluating the quality of debtors; - lending valuation standards; - interest rates; - the methods of guaranteeing the repayment of the loan; - monitoring compliance with the procedure for preparing the loan.
2. Credit registration	<ul style="list-style-type: none"> - forms of documents; - the technological procedure for granting a loan; - control over the accuracy of the credit processing.
3. Credit management	<ul style="list-style-type: none"> - the procedure for managing the loan portfolio; - the control of the execution of the credit contracts; - the conditions for the extension or renewal of the outstanding loans; - the procedure for covering losses; - control over credit management.

Source: elaborated by the author

The main elements of a competent credit policy should include:

- 1) the purpose, according to which the loan portfolio is formed (ie the indication of the loans according to their type, maturity, size and quality);
- 2) a description of the role of the authority in granting loans;
- 3) the practice of verification, analysis and decision making regarding credit transactions;
- 4) the documentation of the credit transaction, which is subsequently stored in the credit file (financial statements, pledge agreements, etc.);
- 5) the basic rules regarding the receipt, evaluation and sale of goods taken as collateral for a loan;
- 6) description of the policy of the interest rate (the conditions for establishing the interest rates and the commissions, the rules of loan repayment);
- 7) enestablishing the application of quality standards for loans;
- 8) limitation of the maximum value of the loans provided;
- 9) a description of the algorithm for identifying, analyzing and solving problems regarding problem loans.

MATERIAL AND METHOD

Any commercial bank independently develops the lending policy and draws it up as an official document containing the main directions of the lending policy and reflects its understanding by the bank's management. As a unit of strategy and tactics of lending operations, this document defines the priorities and objectives of the bank in this field, as well as the instruments and methods

of their implementation. From a practical point of view, the lending policy, besides the main provisions, clearly describes the procedure for organizing the lending process.

The theoretical and practical aspects of the functioning of a bank in the field of lending are largely determined by its method of formation, which is an algorithm that consists of certain stages aimed at obtaining the best optimal result. Given the field of lending, it can be summarized that the effective organization of the implementation process depends on the correctness of its formation, and the distinct stages characterize certain features of interaction with the internal and external environment of the bank. An analysis of the methodological foundations of credit policy formation made it possible to note that, besides the stages, this process is determined by the ideology of a single bank, which will determine the specificity of each specific approach, as it results from the information presented in figure 1.

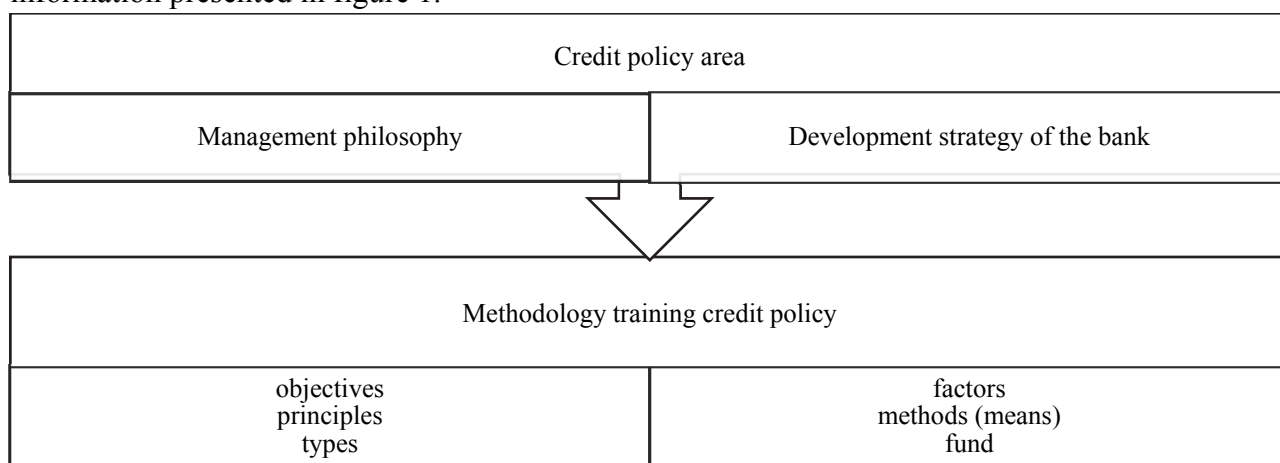


Fig. 1. Methodological scheme for credit policy formation
Source: elaborated by the author

The quality management system of the loan portfolio is based on observing the principles set out in figure 2.

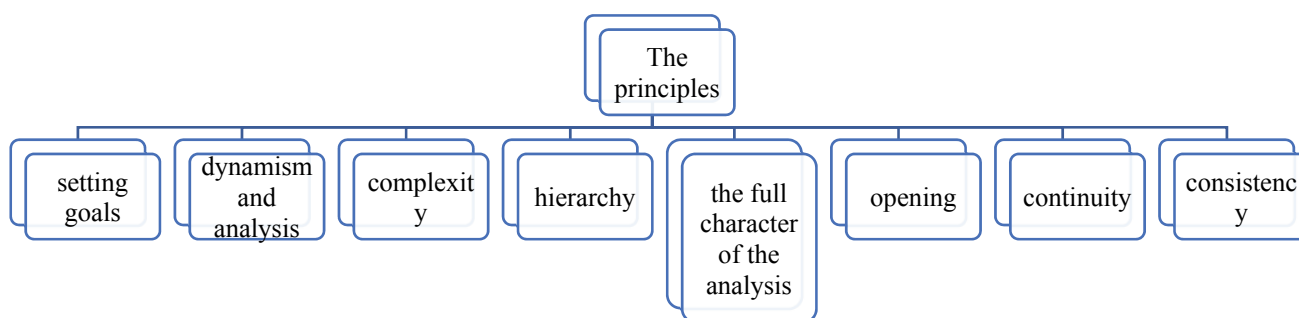


Fig. 2. The principles of the quality management system of the loan portfolio
Source: elaborated by the author after source 3

In order to assess the quality of the bank's loan portfolio, the Russian expert Avseiko proposes to use a complex of indicators grouped in the following compartments:

- 1) evaluation of the lending activity of the bank;
- 2) assessing the level of risk of the lending activity of the bank;
- 3) evaluating the problems of the loan portfolio;
- 4) evaluation of the insurance of the bank's credit placements;
- 5) evaluation of the rotation of the credit resources of the bank;

6) evaluation of the efficiency of the lending activity of the bank [5].

In international practice, for the assessment of the quality of the loan portfolio, the method of numbers is applied, which consists in the fact that for each risk group a list of indicators is determined, based on which reference is made to each specific element of the loan portfolio. Its essence is presented in table 2.

Table 2. Sistemul de numere de apreciere a calității portofoliului de credite al băncii

Rating	Classification	Characteristics
0	Loans not classified	The credit rating is not completed or the credit quality requires reassessment
1	Loans of the highest quality	It refers to the debtor with a high level of solvency, with full and correct payment of the loans in the past, which has an important monetary flow and a high quality pledge. The credit characteristics are acceptable to the bank
2	High quality loans	It refers to debtors with good creditworthiness, who have sufficient means to repay the loan, a positive credit history, an acceptable pledge. The credit characteristics are acceptable to the bank
3	Satisfactory quality loans	It refers to borrowers with acceptable financial status, with generally positive lending history
4	Marginal quality loans	Regularly unstable solvency of the client. Insufficient repayment guarantees. Permanent control is required
5	Loans of lower quality than the marginal one	The repayment of the credit awakens the doubt. An additional agreement is required to establish the credit repayment order
6	Loss	Basic debt and related payments are not paid

Source: elaborated by the author after source 4

The credit policy of a commercial bank has a structure shown in figure 3.

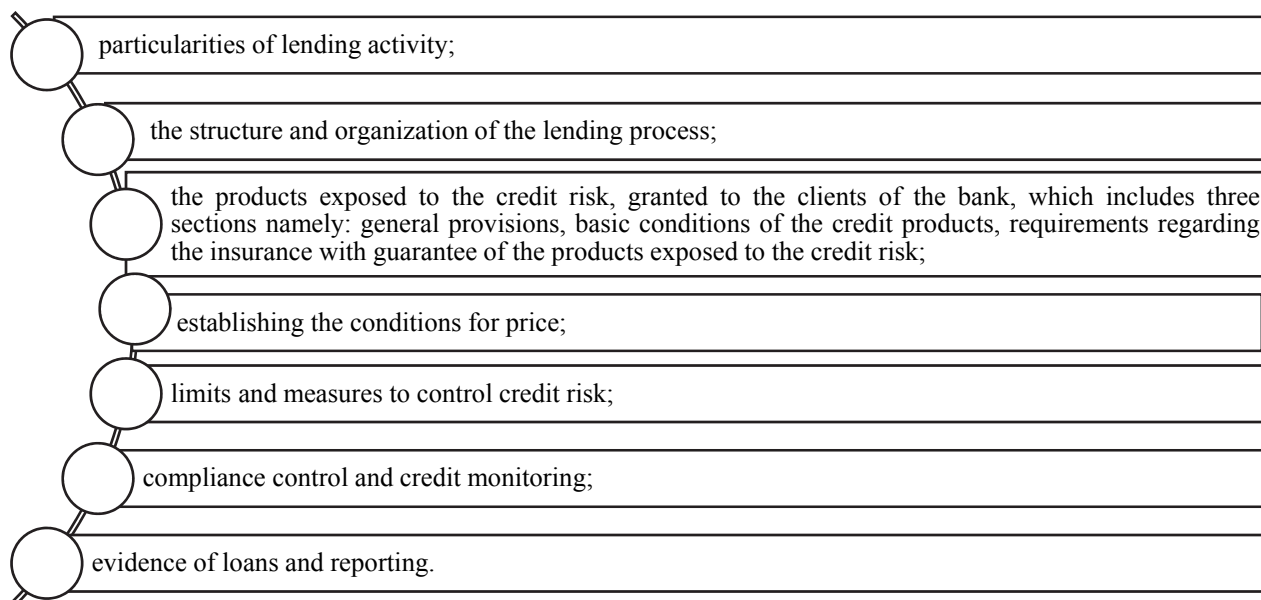


Fig. 3. The elements of the commercial bank's credit policy

Source: elaborated by the author

One of the most important tasks of the commercial bank lending activity is to protect against credit risk, which is due to the possibility of reducing the value of the loan portfolio in the future as a result of the borrower's failure to meet (improperly fulfilled) the terms of the loan agreement. In international practice, the credit risk of a commercial bank increases due to the following factors:

- lack of an optimal lending policy;

- a lending policy that has not been communicated to all performers;
- inconsistent credit policy.

This determines the construction of such a credit risk management system in a commercial bank, which will allow timely identification of emerging credit risks and take appropriate measures to reduce them.

Thus, from our point of view, the optimal credit policy of the bank - in a broad sense - is the bank's strategy and tactics for optimizing the credit risk assumed by the bank, within the norms and standards accepted by law.

RESULTS AND DISCUSSIONS

In our opinion, lending policy is a more multidimensional category, so the identification of the structural elements with the lending process is not the full volume characterizing the specificity of its functioning. We believe that certain elements of it are closely linked, which allows them to be grouped based on a functional purpose. This approach allows us to present the structural model of credit policy based on the following elements, combined in 4 groups, reflected in figure 4.

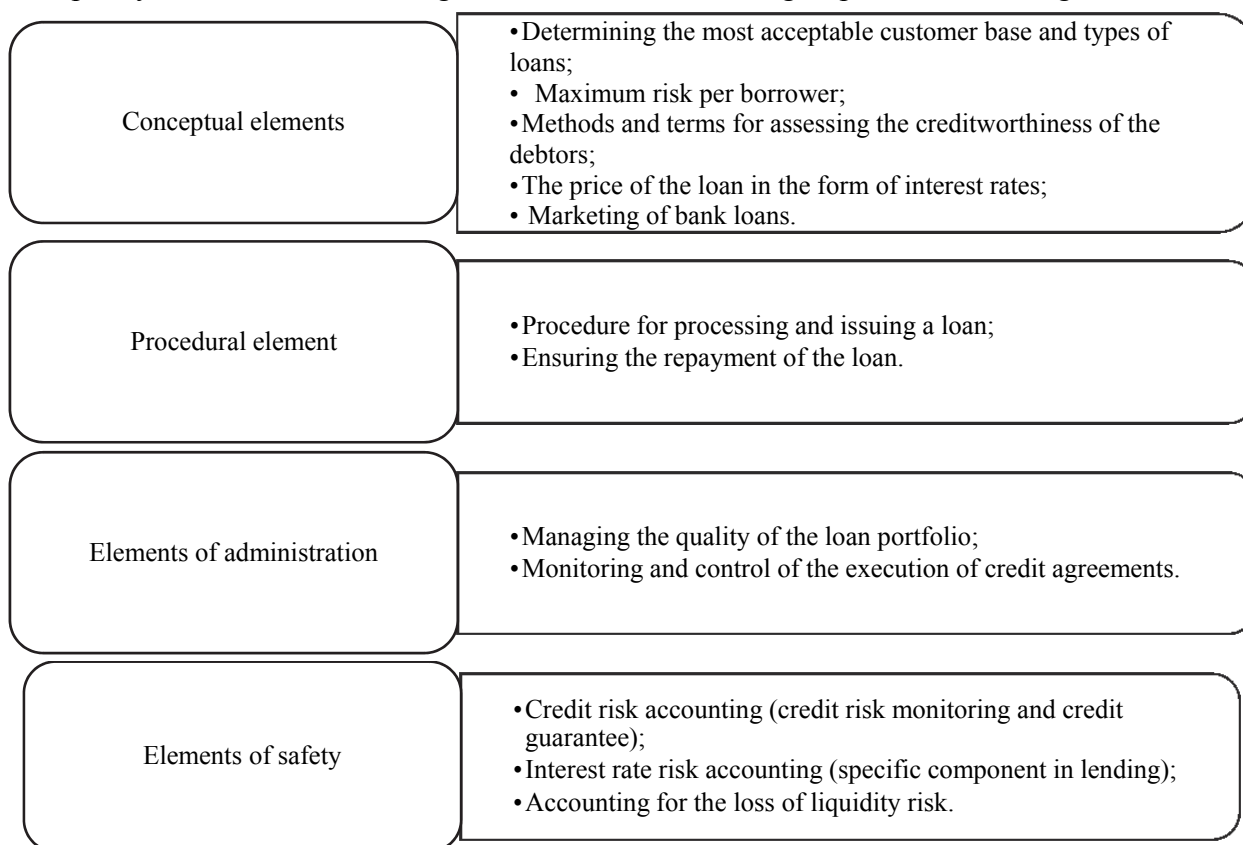


Figura 4. Modelul structural al politicii de creditare

Source: elaborated by the author

The logic of building the presented model is based on the following assumptions:

1. The first group of elements is based on the way in which it is necessary to formulate a lending policy, i.e. related to the development of a certain concept that will allow the credit operations, taking into account the actual demand;

2. The second group describes the procedural elements that reflect the process of implementing the bank's credit activities;

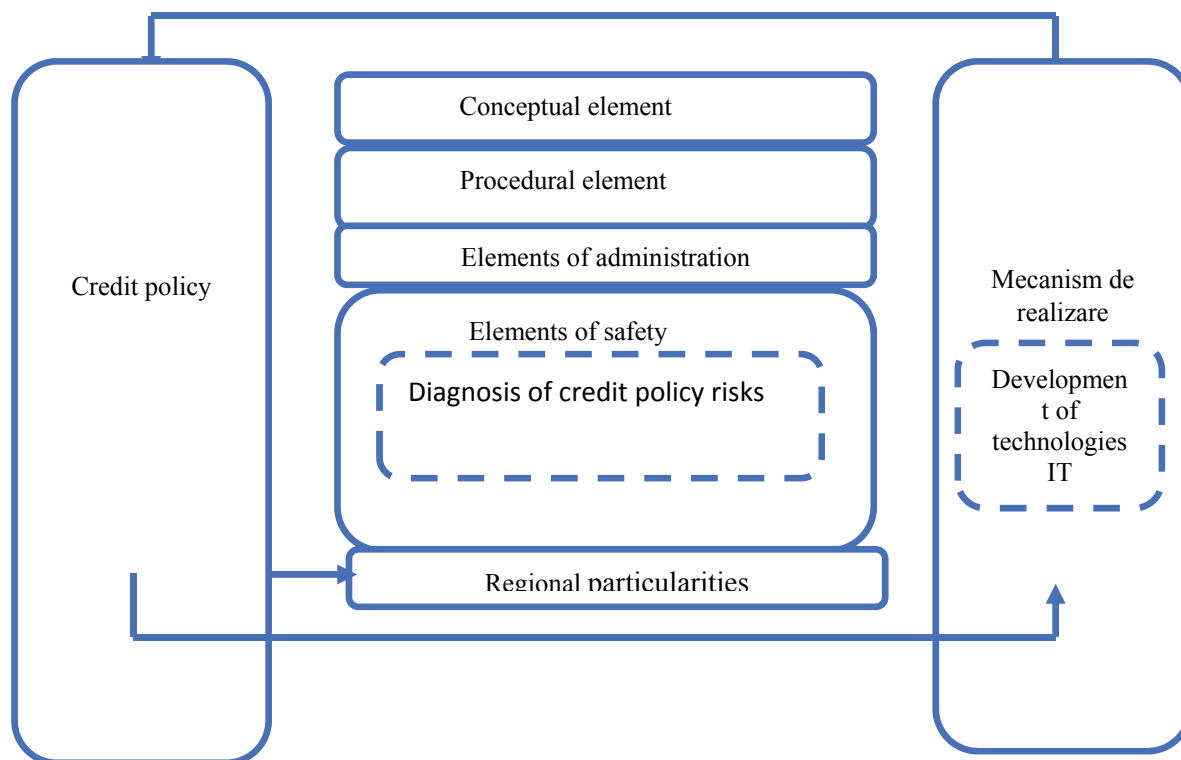
3. The third set of elements allows you to determine how to control the process;

4. The fourth group of elements aims to ensure the security of lending activities and to take into account certain types of banking risks.

Analyzing the information provided, we can conclude about the close relationship and interdependence of the elements of the lending policy, at the same time, in figure 5 the order of their interaction with the derivatives and the basic determinants are presented.

Existing problems that a bank might encounter in developing a credit policy and possible ways to overcome them are:

- large amount of risk. The bank will be able to take the risks of any sectors, sectors, projects, if some of these risks will be assumed by the state;
- restructuring the outstanding debt. When the restructuring is carried out several times, the client can stop paying its obligations, in the hope of a future loyalty of the bank;
- low credit culture. The quality of the loan portfolio provides predictability of income, value of shares and a stable balance. The management of the bank should strive to improve the quality of the credit services provided and not just to increase the loan volume when carrying out an aggressive lending policy;
- the problem of the cadres. It is necessary to carefully select specialists for the formation and monitoring of the loan portfolio;
- information security. The bank should take all measures to prevent the dissemination of confidential information outside the bank;
- poorly developed banking marketing. Most of the population does not know the names of banks, lending programs and their services, so banks should post this type of information in the media.



g. 5. The scheme of interaction of the elements of the credit policy

Source: elaborated by the author

The fundamental point in developing a lending strategy is to minimize the credit risks that may arise due to the insolvency of the borrower. As a rule, in this situation, banks request early repayment of the loan, however, this approach often leads to further deterioration of the borrower's financial situation, leading to bankruptcy, thus reducing the effectiveness of the bank's credit policy and negatively affecting the loan portfolio overall.

The credit risk limitation is based on the creation and implementation of a plan for reducing the associated losses. The credit risk management strategy is considered by the bank as a system of decision-making processes, execution and control of their implementation, so that all the advantages in time for the development of the bank and keeping the risk to a minimum are applied. The bank uses the following basic methods for regulating / limiting the risk of a loan portfolio:

- diversification;
- establishing the limits regarding the conduct of transactions / transactions;
- reservation;
- formation of collateral for lending operations;
- permanent monitoring of timely identification of non-performing debts;
- constant internal control over the compliance of the banking departments with the decisions of the bank's management bodies, of the internal regulatory documents that regulate the procedure for conducting operations and the procedure for risk assessment and management;
- the adequate training of the personnel, including the introduction of new types of lending programs, the provision of consultancy on methodological issues, are considered by the bank as essential conditions for maintaining the highly qualified personnel that ensure the quality of the loan portfolio.

The main instrument for limiting and controlling the credit risk of a bank is the credit limit method. The restriction in the form of the established credit limits allows the bank to avoid losses due to the lack of attention of any type of risk, as well as to diversify the loan portfolio and guarantee its profitability. The limits can be divided into categories of borrowers and groups of borrowers, types of loans, loans in certain areas of the economy, investments with the riskiest loans, including the provision of long-term loans, foreign currency loans, etc.

The limits are applied in the form of the maximum allowable size of the loan and are determined both in absolute values (the value of the loan in monetary terms) and in relative values (coefficients, indices, reports).

Risk limitation is an efficient method of optimizing credit policy, which has a more normative and self-regulatory character. Each bank, depending on the quality of the economic environment and the evolution of its own parameters, ensures the limitation of risks in two ways: global and analytical, as follows:

- setting its own internal limit on its overall commitment to risky (but cost-effective) operations. A maximum limit is set for the weight of risky activities (investments) in total assets or relative to bank capital.

- setting credit ceilings on the debtor, group of debtors, sectors of activity or geographical areas to prevent significant changes in the economic situation of these groups to adversely affect their exposure [2].

- The principles of improving the credit policy of any commercial bank are:
 - the acceptance of the risk by the bank only after its detailed analysis;
 - the unacceptability of the risk, which makes the bank dependent on several very large clients;

- conducting active activities to increase and improve the quality of the loan, assets and liabilities and a reduction of investments in fixed assets;
- making a decision on granting a loan based not only on the assessment and analysis of the guarantee, but also on the calculation of future cash flows and the borrower's profitability;
- differentiating the loan portfolio from the size of loans, sectors and segments of debtors in order to reduce the risk;
- the prevention of the activities of the bank associated with the high losses due to the applied risks: the revenues must cover the total value of the risk;
- establishing the credit limits by the credit committee and exercising control over them throughout the period of granting the borrowed funds;
- obtaining an international credit rating by the bank.

CONCLUSIONS

We consider that in order to reduce the risk from the lending activity and to promote an effective lending policy under the conditions of sustainable financial development, a number of measures must be considered, of which we mention:

a) extension of the database with the history of debtors related to non-banking financial institutions. In this way it will be possible to have an overview of the volume and dynamics of debt throughout the financial system, based on which the measures to maintain financial stability will be better substantiated;

b) increasing the financial culture degree of the population, by presenting the risks to which they can be exposed as a result of indebtedness and of the means of protection against the respective risks, the dissemination of studies and analyzes in this respect, the initiation of financial education campaigns (where the institutions of financial education) credit should play a leading role in orientation).

c) last but not least, by using the information provided by the Credit Bureau and the Banking Risk Center on a larger scale, the information asymmetry related to the credit of the population can be reduced, and the risk profile of the debtor can be estimated more precisely, which leads to reducing the risk from lending.

To effectively manage the reduction of the negative impact on credit risk in the national financial system on the bank, conditions are created for the monitoring of the operating activities:

- clear criteria, methods and procedures for authorizing new loans, as well as renewing and refinancing existing loans;

- the methods of managing the presented credits, including the current analysis of the ability and the debtor to repay the loan under accepted conditions, document monitoring, legal reserves, contractual requirements and guarantees, the system of classification appropriate to the nature, size and complexity of banking activities or at least the system of banking activities asset classification;

- a comprehensive system of methods and procedures for permanent reporting of credit positions;

- establishing an efficient control and monitoring the credit and the size of the limits of the issued loans.

The main strategic task for banks is the formation of a resource base, including by increasing the number of subdivisions, which will enable the bank's policy in the field of providing customers with the widest spectrum of high-quality banking services, including using advanced technologies.

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