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## BANKING CREDIT POLICY AS A SPECIAL INVESTIGATION OBJECT

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*Анотація. У статті досліджено сутність та особливість формування і реалізації кредитної політики комерційного банку. Проаналізовано структуру та динаміку кредитів, наданих банками в кризовий та посткризовий періоди. Виявлено проблеми, що виникли у процесі кредитування та доведено їх вплив на розвиток економіки України.*

*Summary. The article deals with the essence and peculiarities of commercial bank credit policy formation and implementation. The structure and dynamics of the loans given during crisis and post-*

*Аннотация. В статье рассматривается сущность и особенность формирования и реализации кредитной политики коммерческого банка. Анализируются структура и динамика кредитов, предоставленных банками в кризисный и посткризисный периоды. Выявлены проблемы, возникшие в процессе кредитования и доказано их влияние на развитие экономики Украины.*

*crisis periods have been analyzed. The problems arising in the process of lending have been identified and their influence on the development of Ukraine's economy has been proved.*

**Ключові слова:** комерційні банки, кредити, кредитна політика, кредитний портфель, кредитні операції, ризики, кредитна заявка, кредитний менеджер, прибуток, кредитний комітет, кредитний моніторинг.

**Ключевые слова:** коммерческие банки, кредиты, кредитная политика, кредитный портфель, кредитные операции, риски, кредитная заявка, кредитный менеджер, прибыль, кредитный комитет, кредитный мониторинг.

**Key words:** commercial banks, loans, credit policy, loan portfolio, credit transactions, risks, credit application, credit manager, profit, credit committee, credit monitoring.

**Statement of the problem.** The main priority of the state social and economic policy is to provide high level and stable rates of its economic growth. It is impossible to fulfill the task without increasing the role of the banking sector in economy, effective fulfillment of the task of satisfying financial needs of the real economy by the banking system. The banking sector development dynamics depends much on the state of the legal environment, investment, business climate, tax conditions, improvement of banking activities regulation and the system of banking supervision, effectiveness of the existing deposit insurance systems, access to credit resources including external ones. In the conditions of global economy these factors acquire a special meaning as it has been proved by the world financial crisis which involved Ukraine's

economy. Under such conditions the problem of lack of lending to the real economy has been exacerbated.

In the modern economic life of Ukraine a stable tendency of the role of commercial banks growth is observed. Effective crediting nowadays is one of the most important and topical tasks of Ukraine's banking system. Market transformation of national economy has opened a new stage in the development of crediting. It led to the problem of scientific comprehension of new phenomena in the sphere of crediting, understanding of their contents, nature and essence, the development of effective schemes and technologies of crediting process and their application in practice. Commercial bank credit policy forms the basis for the whole process of crediting, its objective characteristics and peculiarities.

The topicality of banking credit policy investigation as a special object is confirmed by modern tendencies in the development of country's economy.

**The analysis of the recent publications and research.** The research of the essence and current tendencies in the formation and realization of credit policy have been reflected in the works of foreign and domestic scientists: I. Balabanov, H. Panova, O. Lavrushyn, O. Baranovsky, V. Mishchenko, A. Moroz, T. Smovzhenko, O. Vasiurenko, V. Vitlynsky, Y. Nakonechny, O. Pernarivsky, I. Peshchanska, L. Prymostky etc.

**The aim of the article** lies in clarifying the nature, formation stages, realization and the analysis of the current state of Ukraine's commercial banks credit policy.

**Ground of scientific results.** Commercial bank credit policy (in its broad sense) should be viewed as a complex of actions and measures taken by a commercial bank in the sphere of crediting aimed at solving strategic and tactical tasks based on macroeconomic and microeconomic regional and branch factors to optimize credit operations access and credit risks. In the narrow sense it should be regarded as a necessary confidential document which contains a list of rules for conducting bank crediting fulfilled within a year and then reviewed by the Credit Committee.

The definition of the elements is complicated by the existence of specific peculiarities of credit policy:

1. Each bank works out independently its credit policy meeting the requirements of its activities and is based on the legal and executive documents of external and internal origin (is of individual approach).

2. It is based on the results of macro and microeconomic regional and branch factor analysis.

3. It takes into consideration subjective sides of bank functioning in accordance with general market strategy that is the basis of the process of bank organization.

However, problems dealing with the definition of elements and the holistic approach forming and realizing credit policy attract financial specialists within adaptability for each bank under the conditions of vigorous competition.

Credit policy defines standards, options and procedures applied by bank employees when lending. The set of elements of credit policy is precisely presented by I. Peshchanska who takes three stages of lending as the basis:

- 1) preliminary work;
- 2) lending itself;
- 3) management of credit [4, p. 119].

But the realization of credit policy by modern commercial banks is carried out in two stages:

- a) preliminary work;
- b) management of credit.

These changes are the result of vigorous competition, that's why the time between the first contact of the borrower and the decision of the bank about the loan is reduced.

Proper banking crediting, the development of effective and flexible system of credit operations management, appropriate provision by efficient and reliable accounting information serve as the basis of financial and market stability for commercial banks. To provide effective crediting activities commercial banks work out their own internal credit policy and implement practical ways of its realization. That's why one of the most important tasks of credit activities management is the formation and analysis of the commercial banks loan portfolio.

The development of credit policy is especially important in the conditions of banks adaptation to complex and constantly changing conditions of market economy reforming and peculiarities of the world economic and financial crisis conduct.

All important bank solutions need the maintenance of optimum ratios between loans, deposits, other obligations and equity. That's why proper credit policy is able to increase loan quality and the financial state of the bank. The above mentioned observation stresses the necessity of credit policy in bank activities. It is especially important in the transition period to market conditions when the banks are targeted at wealthy and rich clients that can maintain the whole banking system neither quantitatively and qualitatively.

The strategy of credit policy should include priorities, principles and aims of a definite bank in the conditions of the credit market. Firstly, it is determined by the client selection, secondly, by the norms and rules which regulate the practical activities of the banking staff, thirdly, by bank administration competence and the level of staff qualification involved in the process of crediting. The tactics of crediting policy embraces definite tools used by a separate bank for realizing its strategic aims to implement crediting operations, ways of its improvement, and order of credit process organization. So, credit policy creates necessary general background for the effective work of the staff of bank crediting department, reduces the likelihood of errors and making irrational decisions.

The main element of credit policy in the strategy sphere is the correct choice of its aims. The targets of the bank credit policy are defined by the strategic targets of the bank.

The system of core targets of a commercial bank credit policy in current conditions should include:

- provision of the maximum yield of credit portfolio and equity of the commercial bank with minimal risk;
- the support of optimum ratio between credits, deposits and other obligations and bank equity;
- the provision of financial stability of a commercial bank in the process of credit activities;
- the provision of reasonable and optimum usage of credit resources;
- the achievement of optimum balance between the credit portfolio volume increase and quality improvement rates;
- the expansion of customer base by providing credit services of high quality;
- the perseverance of deep trust of legal entities and individuals to commercial banks by due and full fulfillment of obligations before customers.

Credit policy determines general directions in the adoption of definite solutions concerning the choice of reliable customers, volumes and terms of credit and includes the following elements:

- 1) credit agreements conditions (combination of agreed terms of credit and interests);
- 2) solvency standards ( requirements to financial stability of clients);
- 3) means of providing fulfillment of credit obligations (is used to clients, who have arrears).

The process of making a decision concerning crediting consists of several main stages, each of them defines the characteristics of a loan, ways of lending, its usage and paying off:

- 1) the preliminary review of loan application and the interview with the customer;
- 2) the analysis of borrower's creditworthiness and solvency; security assessment;
- 3) the final decision concerning crediting by the bank credit committee;
- 4) execution of documentation governing the relationship between the bank and the borrower;
- 5) issuance of credit;
- 6) credit monitoring.

The preliminary review of loan application (guarantees) is executed within 1-2 days after contacting the bank. Credit consultant gives the necessary information about credit conditions and a borrower explains the essence, history and perspective of his business (if the borrower is a legal entity) or the purpose of the loan and what sources he will use to pay the loan off including the interests. At this stage the bank makes the decision about the possibility of loan.

The bank also figures out:

- 1) seriousness, reliability and creditworthiness of the borrower, his reputation as a potential business partner;
- 2) the validity of the necessary credit and degree of its return;
- 3) the correlation between credit offer and bank credit policy and the structure of its loan portfolio formation.

If the conditions of credit product correlate with bank credit policy and fundamental demands to the client, a credit manager is appointed, who contacts him for further detailed revision of the crediting project. A future borrower should prepare and submit a credit application as well as supporting documents required by the bank.

The necessary consultations concerning the preparation of information are conducted by credit authorities.

The detailed analysis of crediting project is carried out during 5–10 days if the results of the preliminary application revision are positive including the whole set of necessary documents.

At this level the bank reviews creditworthiness of the borrower in three stages:

- 1) the calculation of basic (objective) indicators that characterize the financial status of the borrower;
- 2) determination of additional (subjective) indicators;
- 3) the analysis of creditworthiness of the borrower.

Using the information given by the client in the set of documents, a credit manager of preliminary analysis and monitoring department prepares the conclusion for the credit committee involving other bank departments including lawyers, authorized bank experts etc. The obligatory conditions while preparing the conclusion concerning the legal entity are the following:

- 1) the visit of the loan officer to the location of the object that is credited;
- 2) the visit of credit officer with bank experts to the location of the collateral;
- 3) involvement of independent companies to assess the collateral.

Offered credit conditions before the revision of the credit committee are discussed with the borrower. The final decision about lending, issuing guarantees, modifying the terms of the loan agreement or rejection is done by the credit committee.

If the credit committee's decision is negative the bank submits a grounded refusal in lending (guarantees) or an offer to change some conditions.

An important step in bank lending after the positive decision on funding is the documentation governing the relationship between the parties. It includes:

- 1) loan agreement;
- 2) security agreement;
- 3) contract of guarantee (third party);
- 4) letter of guarantee (third party);
- 5) contract assignment;
- 6) another contract.

The credit is given after the borrower has fulfilled certain conditions specified in the loan agreement, by opening the client loan account and transferring funds to its checking (current) account through the provision of payment orders according to the amount and purpose of the loan.

The final stage of the lending process is further supervision over the implementation progress of the loan project and credit monitoring.

The provision of effective and reliable credit operations demands that a commercial bank should constantly organize monitoring of all stages of credit process. Monitoring starts immediately after lending money to the client (getting the loan). The main aim set by the bank to control credit operations lies in effective organization of credit process and search of the improved credit mechanisms.

Bank monitoring and management of credit process is a prerequisite for optimizing the system of lending at commercial banks.

In the process of monitoring credit operations a bank should focus its attention on the following problems:

1) observation of the principles of lending (task orientation, security, urgency);

2) identification of problem loans and the development of measures to eliminate debt;

3) analysis of the quality and structure of the loan portfolio as a whole;

4) credit risk control;

5) credit market monitoring and the development of measures to increase the bank's participation in it etc.

The requirement of timeliness and completeness of the loan is inseparable from the question of direct control over the size and quality of the obtained provision. The bank supervises the proper use of the loan. For non-performance or improper performance assumed in accordance with the loan agreement obligations a guilty party is to compensate the other party all losses caused by the latter and pay the penalties and fines stipulated in the loan agreement [14, p. 69].

Crediting has been and still is the main source of commercial bank profit.

In early 2012, balances of loans given to residents by banks of Ukraine made up to 801,809 million hryvnias, an increase of 1,3 % per year. The dynamics of lending in pre-crisis and post-crisis periods is presented in Figure 1.

The share of long-term loans in the loan portfolio decreased by 12,4 % as of 01.01.2012 while it was 64,1 % as of 01.01.2009. Analysts say that long-term loans are the main driver of economic development and the indicator of banks confidence in borrowers.

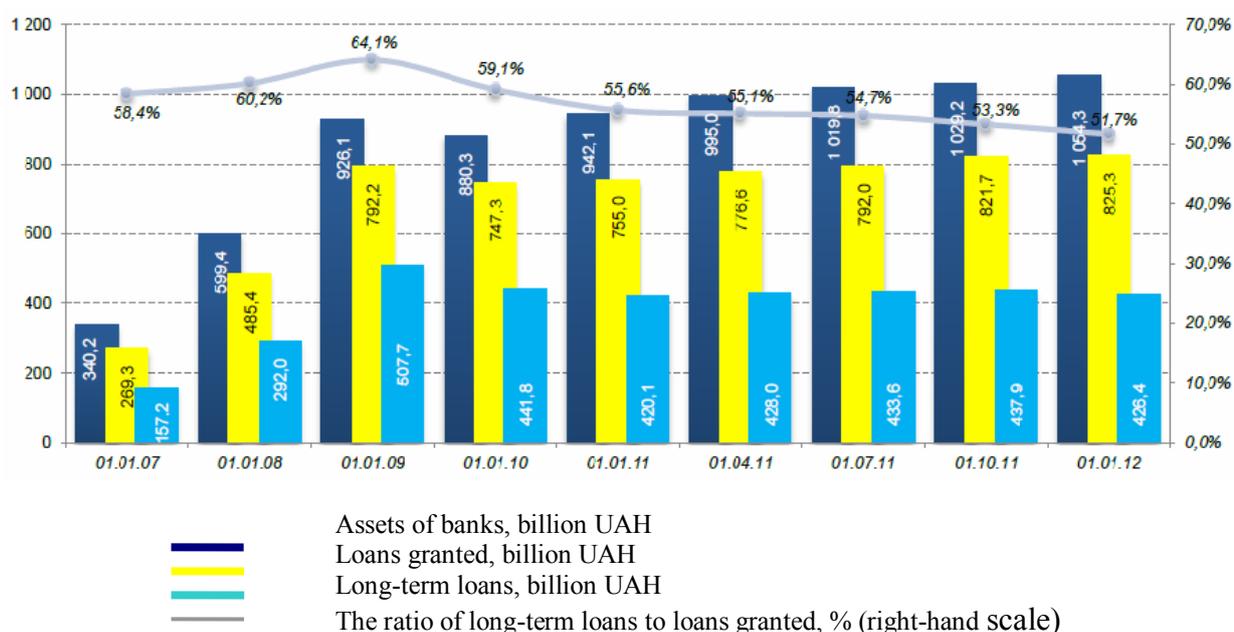


Fig. 1. The structure and dynamics of loans given by banks of Ukraine

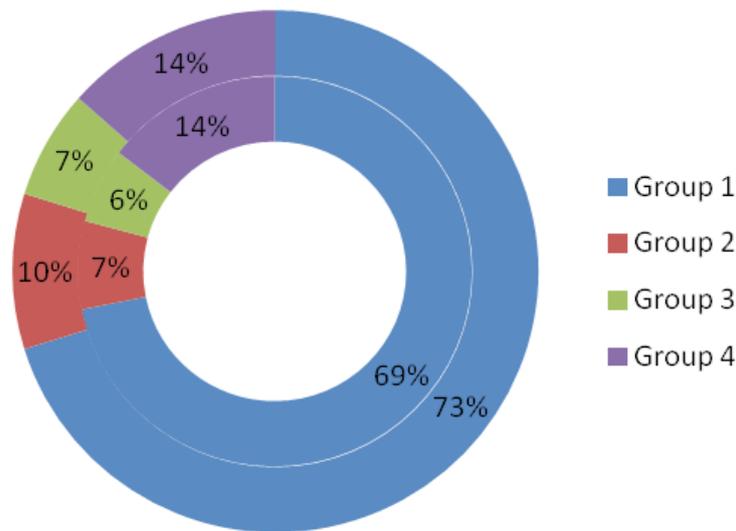


Fig. 2. Share of loans given by banks of Ukraine

The comparison of loans according to the groups of banks as of 01.10.2012 with the same period in 2009 is shown in Figure 2.

The share of loans of the largest banks as of 01.10.2012, compared to the same period in 2009 decreased by 4 %, the share of loans of large banks has not changed, medium – increased by 1 percent, and small – by 3 percent.

**Conclusion.** Nowadays one of the most important roles to stimulate reproducing processes in the economy is played by banking credit as the main

source to provide enterprises and the needs of the population with money resources.

Proper banking crediting, the development of effective and flexible system of credit operations management serve as the basis of financial and market stability for commercial banks. Commercial bank credit policy embraces the circle of key objectives and tasks of bank activities, defines definite ways, methods and techniques of its realization to maximize the return on lending operations and achieve an acceptable level of banking risks in lending.

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