

Modernization of the system of credit risk management in the second tier banks of the Republic of Kazakhstan

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Abstract. This article considers the key issues of credit risk management of second-tier banks of the Republic of Kazakhstan. It was revealed that currently, certain tendencies are growing, which will most probably adversely affect the indexes of overdue and potentially non-returnable consumer debts. In 2013, the scopes of consumer lending, including unsecured loans, rose in the country; and the worsening of the loan discipline of the population of the Republic of Kazakhstan was observed, which will surely adversely affect the quality of loan portfolios. The article suggests two new unique instruments, which will help loan institutions to improve their risk management systems.

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Introduction

The recent world financial crisis exposed the deficiencies of the corporate risk management on the level of separate loan institutions, which risks are usually not determined in the circumstances of stable macroeconomics [1]. The financial crisis of 2008 and the European debt crisis of 2009-2012 have shown that macroeconomic and financial terms for commercial banks can change quickly.

Therefore, ensuring quality of assets and profitability in response to the environmental changes remains an urgent issue [2]. At the same time, as evidenced by researches, in the circumstances of instability of the external environment, financial analysts of many banks face difficulties at estimating and forecasting credit risks [3].

The urgency of creation of an efficient tool allowing to estimate really the existing risks and to consider their cost at taking commercial decisions, including decisions on loans, increases in the current circumstances.

Body of the work

The banking sector holding the strategic position in the economic system of any country possesses sufficient potential and performs rather important functions associated with accumulation and redistribution of funds, adjustment of the offer of money in the economy, and harmonization of payments. At the same time, due to the specificity of the business of loan institutions, the latter are the carriers of risk, which often has a systemic nature, which is evidenced by the bank crises, particularly the last global financial and economic crisis, which exposed weak positions both in adjustment and supervision of the banking activity, and the quality of management in commercial banks [4, pp.7].

Lending operations of commercial banks are one of most important banking activities. In the circumstances of the competition growth and strengthening struggle for income redistribution in the market, loan institutions try to find more efficient methods of attraction of solvent clients, simultaneously trying to manage their own losses better [5, p.10].

In the financial market of Kazakhstan, lending remains the most profitable asset of loan institutions, though the most risky one. As of January 1, 2014, 38 second-tier banks (STB) operated in the Republic of Kazakhstan, the assets of which constituted 15,461.7 billion tenge. The majority share in the structure of assets belongs to bank loans and reverse repo operations – 64.6% [6].

Integration of risk management into the general system of bank control is very important, especially now, at the time of financial instability, which has been lasting for several years so far due to the financial crisis.

In 2008, when development of the financial crisis became seriously harmful, the most important issue for that period was the coordinated actions of public bodies of Kazakhstan, which was to prevent the system risk development.

One of significant documents that was adopted is the Participatory Action Plan of the Government, the National bank, and the Financial Inspection Agency on stabilization of the economy and the financial sector in 2009-2010 [7]. According to this plan adopted on November 25, 2008, the government steered funds in stabilization of the financial sector in order to arrange temporary participation of the government in rendering help to four banks: BTA including its affiliated Temirbank

JSC, the JSC Halyk Bank, the Kazkommertsbank, and the Alliance Bank.

The taken measures of state regulation of the Republic of Kazakhstan positively influenced on stabilization of the banking sector's position. For example, in 2008-2010, there was a growth rate reduction and in 2010 – decrease in volumes of the disbursed loans by second-tier banks of the Republic of Kazakhstan. During the post-crisis period, there was recovery of increment rates of loans disbursement: in 2011, 10,442.9 billion tenges (the gain is equal to 15.2%), in 2012 – 11,656.6 billion tenges, i.e. the gain is equal to 11.6% compared to the previous year level (Figure 1). For the last 7 years, the scope of loans disbursed by banks of Kazakhstan has increased almost twice, and the GDP – almost three times.

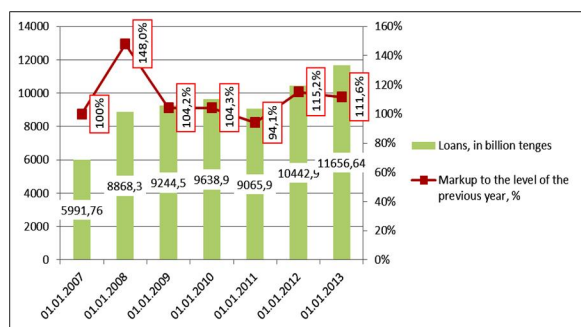


Figure 1 – Dynamics of scopes of loans disbursement by banks of Kazakhstan during 2006-2012

Nevertheless, today the National Bank of Kazakhstan and the banking system continue trying to overcome the residual phenomena of the crisis times. For example, the level of credit risk for steady performance of the banking sector remains high, as the high level of non-performing loans in the loan portfolio of banks does not allow them lending to the real sector more actively.

The considerable part of the general credit portfolio is constituted by the overdue loans, the share of which as of January 1, 2012 was equal to 34.66%, and as of the similar period of 2013 decreased to 33.11% (Figure 2) [8].

As of the beginning of January 2014, the share of loans with the debt over 90 days in arrears in the credit portfolio of banks reached 31.3%, namely 4.1 trillion tenges. It is obvious that the target indicators declared by the government (not more than 15% of problem loans by the end of 2014) will be hardly reached if effective regulative measures on essential clearing of loan portfolios of banks are not taken.

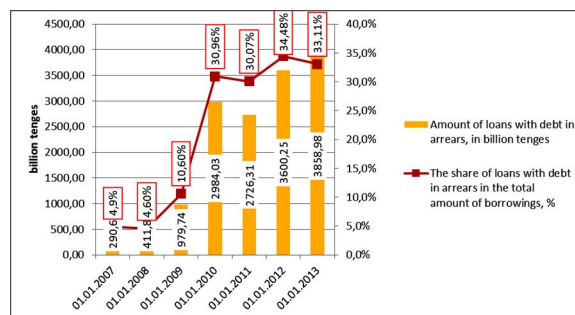


Figure 2. Dynamics of overdue credits of second-tier banks of Kazakhstan

In comparison with previous years, negative dynamics of non-performing loans remained in Kazakhstan – in 2010, the volume of NPL constituted 32.59%; in 2011 – 34.97%; and in 2012 – as much as 36.68% [9]. It is to be noted that in 2012, Kazakhstan took the first place in the anti-rating of the World Bank by the share of NPL (non-performing loans) in the total scope of disbursed loans in the country's economy [10].

At that, more than 83% of the total amount of non-performing loans belongs to six second-tier banks. The "leader" by the scope of non-performing assets is the BTA Bank JSC with its 87%. It is followed by the Nurbank JSC (50%), the Temirbank JSC (46.77%), the Alliance Bank JSC (44.53%), and the ATF Bank JSC (41.4 %). At the end of this list, the Kazkommertsbank JSC is with its level of non-performing loans equal to 40.4%.

A large share of the loan portfolio of poor quality is concentrated in the banks that have restructured their obligations. Concentration of the credit risk in these banks is explained by the more aggressive loan policy, which they adhered to during the pre-crisis period, and the high level of accepted risk along with imperfection of the system of the risk evaluation.

Positions of four largest second-tier banks (the Kazkommertsbank JSC, the JSC Halyk Bank, the ATF Bank JSC, and the JSC Bank CenterCredit) is more vulnerable, as they possess the lowest share of performing loans generating income, which together with the high level of expenses for creating provisions under loans affects the profitability and the further development of these banks.

By escalating lending to large businesses, large and mid-sized banks with foreign participation (the Citibank Kazakhstan JSC, the SB HSBC Bank Kazakhstan JSC, the SB RBS (Kazakhstan) JSC, the SB Sberbank JSC, the Subsidiary Organization VTB Bank (Kazakhstan) JSC, the SB ALFA-Bank JSC) carry out active loan policy targeting expansion of their presence in the market of Kazakhstan. Better

quality of the credit portfolio, moderate operational expenses, availability of cheap sources of funding ensure competitive advantages of STBs with foreign capital, which allows them to receive stable financial results.

STBs with domestic capital (the Nurbank JSC, the Tsesnabank JSC, the Kaspi Bank JSC, the Eurasian Bank JSC, the Alliance Bank JSC, and the Temirbank JSC) demonstrate extensive lending activity. At the same time, the lending policy of these banks is substantially targeting the retail lending which consists of high risk and insecure consumer loans.

Prompt growth of retail lending at the expense of high-risk loans in cash and insecure consumer loans results in rising loan risks. Some fears are caused by the high rate of retail lending growth. For example, the volume of disbursed consumer loans during 2011-2013 increased 2.2 times and equaled to 2,241.1 billion tenges. The share of consumer loans in the total loan portfolio of STBs equaled to 21.7%. The current threats associated with consumer lending are insignificant. However, the high value of the growth of the consumer loans portfolio against the background of low rates of lending to industries of the economy, low profitability of assets, and the decrease in 2013 of the value of capital adequacy can become the area of future loan risks and limit the ability of banks to recover this situation at the expense of profits capitalization.

The loan portfolio structure by economic activities allows determining the areas of increased concentration of the credit risk and channels of potential overflow of corporate sector risks. The largest share in the loan portfolio of banks belongs to loans disbursed to the building industry (Figure 3), 33.4% of which were non-performing ones as of 01.01.2013.

The second place by the volume of disbursed loans belongs to trade (18.6%); at that, the share of non-performing loans constitutes 26.9%. As the trading enterprises are highly dependent on bank loans, the trading industry is exposed to increased risk. Decrease in profitability or deterioration of business activity indexes of trading enterprises can result in the inability of the accumulated debt servicing.

As a whole, the level of risks in STBs in the Republic of Kazakhstan has been remaining at an acceptable level during several years (Table 1).

However, the high level of the credit risk remains crucial for steady operation of the banking sector, as the high level of non-performing loans in the loan portfolio of banks does not allow them to credit the real sector more extensively.

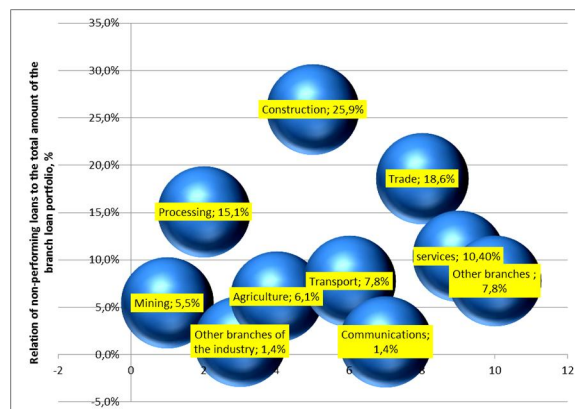


Figure 3. Branch structure of the loan portfolio as of 01.01.2013

At the same time, the National Bank of Kazakhstan has implemented special mechanisms for "clearing" the balance sheet of banks from non-performing loans (establishment of the FPK JSC, the Organization for Management of Problematic Assets, and waiver of bad loans without tax obligations), which will contribute to the solution of this problem to some extent.

Table 1. Dynamics of sub-indexes in the structure of the aggregated index of financial stability to STBs of the Republic of Kazakhstan

	01.01.2011	01.01.2012	01.01.2013
Capitalization index	1	1	1
Index of the loan portfolio quality	4	4	4
Credit risk index	3.6	3.6	3.6
Market risk index	2.2	2.2	2.2
Index of operating efficiency	1	4	2.5
Liquidity index	1.67	1.7	1.56
Aggregated index of financial stability	2.25	2.75	2.48

Besides, the National Bank regularly evaluates the banking sector's resistance against possible negative macroeconomic scenarios by means of the stress-testing technique. The latest results of stress-tests published in the "Report on the Financial Stability of Kazakhstan in 2012» [11] showed that, despite rather large scope of expected losses, the level of capital adequacy of banks is within the limits of admissible values.

Currently, the National Bank of Kazakhstan is developing measures on restriction of growth of consumer lending and decrease in the level of the debt load on the population. In 2014, the National Bank toughens requirements to STBs regarding formation of capital at consumer lending operations. Restriction of the index of insecure loans growth rate

not exceeding 30% through implementation of corresponding prudential standard specification is introduced. Besides, the maximum value of the debt load of a physical person not exceeding 50% of his monthly income is stated. These measures will allow to lower the scope of non-performing loans and to reduce the risks of the banking system of the Republic of Kazakhstan.

However, instability of the global financial market, uncertainty of development of the world economy require strengthening of preventive measures targeting the reduction of credit risks in the Republic of Kazakhstan: improvement of the financial infrastructure by means of further development of credit bureaus, improvement of innovative scoring tools, risk-certification systems, formation of the uniform register of mortgage property, etc.

Establishment and development of credit bureaus is an efficient method of risk reduction and optimization of lending costs of STBs of the Republic of Kazakhstan targeting reduction of risks associated with active operations of loan institutions.

Between 2004 and 2012, the infrastructure of formation of credit records of Kazakhstan included only one private institution – “The First Credit Bureau” LLC (FCB). Clients of this organization are all second-tier banks and microcredit organizations of the Republic of Kazakhstan. The cooperation scheme assumes transfer by lending establishments of the information about borrowers and acquisition of the data about potential clients from the existing base of the FCB.

In 2012, according to recommendations of the World Bank, the National Bank of the Republic of Kazakhstan established the specialized non-profit organization AC "State Credit Bureau" [12], the primary objective of which is the creation of a reference database of credit records. The obligation of second-tier banks, microfinancial organizations, and organizations rendering certain banking services, as well as entrepreneurs selling goods or services on credit is stated on the legislative level [13].

The bureau information will allow to create a basis for effective state regulation and supervision of measures on ensuring stability of the financial system. Loan institutions can promptly receive reliable financial data on the solvency status of loan applicants and based on the data estimate the risk degree of the forthcoming transaction.

The aspiration of STBs to minimize the probability of losses incurred because of the failure to fulfill, or untimely or incomplete fulfillment by borrowers of financial liabilities according to the terms and conditions of loan agreements determines the necessity of improvement of risk-management

technologies and modernization of credit risk management systems at banks.

Scoring and scoring bureaus become the key elements of risk management, which determine its efficiency. Maintaining the high speed of decision-making and considering a solid flow of requests, STBs try to ensure qualitative verification of every borrower in order to reduce credit risks as much as possible. The solution of these tasks demands effective IT tools, which would ensure flexibility of the loan strategy based on the multilateral analysis of the information on borrowers and the quality of the loan portfolio of a financial organization.

The line of scoring IT solutions based on FICO products developed by experts of the American company Fair Isaac Corporation causes special interest [14]. Currently, FICO scoring estimations are used by 21 countries and have proved their efficiency. For example, the automated system FICO™ Falcon® Fraud Manager 6 is the most accurate and powerful solution currently dedicated to detection of fraud with payment cards, helping to reduce losses to 50%.

The FICO® Economic Impact Index analytical tool helps to make decisions in the area of credit risk management, adjusting them to expected changes in the macroeconomic situation.

The FICO scoring estimates give the chance to loan institutions to make exact, reliable, and prompt decisions that would minimize credit risks throughout the life cycle of work with a client. They allow to range consumers by the probability, with which they will carry out their loan obligations under a loan agreement.

The FICO® Application Fraud Score analytical tool will allow Kazakhstani banks to receive information on possible risks of fraud and help preventing possible fraudulent actions of potential borrowers at the earliest stage before the loan account has been generated. Thus, the loan institutions will receive protection against losses incurred with the loan disbursement.

Another important innovation in the evaluation system is the scoring bureaus taking into account social communications of the borrower. The information on financial behavior of the social environment has been integrated in the scoring model, which ensured the growth of the forecast power to 11% [15].

With a view of minimization of risks in the segment of corporate lending, the basic measures of STBs should pursue improvement of quality of potential clients' solvency evaluation, development of new forms of loans securing, and improvement of the mortgage mechanism. It is necessary to arrange current monitoring of the solvency of clients,

counterparts, and issuers on a regular basis and develop recommendations about changing the existing limits and debt management.

Thus, when rates of the retail lending market growth will slow down because of more balanced lending policy of the leading banks, the competition on the banking market will pass to a principally new level. In this struggle, the advantage will be gained not by the loan institutions, which will have managed to increase their loan portfolios faster, but those who will be able to forecast new threats and upgrade their risk management systems.

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