PROBLEM LOANS MANAGEMENT PRACTICES:

ECOBANK GHANA LIMITED AS A CASE STUDY

By

Katoh Hamadou KONE

Being a dissertation submitted in partial fulfilment of the

requirements for the award of the

MBA in Banking and Finance

To my Mother, for her tireless support

May the Almighty God bless and reward You for All.

Hamed

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ACKNOWLEDGEMENT

Before starting with the study, allow me to thank people and organizations without whom this study may not be completed.

My first words go to international institutions that created and are still supporting the MBA in Banking and Finance, especially the African Capacity Building Foundation that granted me a scholarship to attend the Program. May you keep strong to continue sustaining African development through training programs and others.

Special thanks also to the academic staff for providing us with up to date knowledge in banking and finance and the project manager and his short and dynamic team.

The Ecobank Group and particularly its subsidiary of Ghana, Ecobank Ghana Limited, played a key role in the completion of this study. I thank the bank for its hospitality during those three months at Trade Finance and Risk Management Departments and wish you to remain a key role player in the African financial environment.

I cannot forget Mr. Theophilus Aryee, Director of my dissertation for his effective commitment to the work. To him I will say "*I learnt a lot from you and expect to do more*".

I end by my large family that I would like to thank for their moral and financial support. I pray for the time to allow all of you to get the proceeds of your investment.

FOREWORD

Globalization, to be effective, requires the actual involvement of all countries of the world. Unfortunately, the level of development of Africa is questionable about its contribution to the success of globalization. Many projects are initiated by international organizations to help the continent to be competitive and play a significant role in the world economy.

The MBA in Banking and Finance is part of those projects, which aim is to reduce the gap between developed and emerging countries.

The MBA in Banking and Finance is a post-graduate bilingual program in banking and finance. It was established in collaboration with the BCEAO, the BEAC, the Bank of France, the French Development Agency, the European Union, the World Bank, the French Ministry of Foreign Affairs and the African Capacity Building Foundation.

Africa like the rest of the world needs to be competitive and must comply with international standards. Banking and Finance are areas where techniques and methods grow at a very high speed. It was then important to provide to Africans high skills in bank and risk management, value creation, corporate finance, financial markets techniques and others.

Since financial markets and techniques are not yet well developed in the continent, the most important risk banks are exposed to is credit risk, that is the default of a borrower to meet his obligations. This risk is worsen by the growing number of banks and the competition deriving from, the need for financing to develop the countries, the ineffectiveness of banking supervision among others.

For these reasons, we worked on the topic: "*Problem Loans Management Practices: Ecobank Ghana Limited as a case study*".

Essential data to engage the research were collected during our three-month internship period at the Bank. This work is part of the requirements for the Award of the MBA in Banking and Finance.

EXECUTIVE SUMMARY

This study aimed to improve problem loans management practices at Ecobank Ghana Limited in order to reduce loan losses.

The reasons that justify the choice of this topic were as follows:

- Most of world financial crises were due to large amount of doubtful loans in banks' portfolio especially in Japan and China among others.
- West Africa is exposed to the problem because of the growing number of financial institutions (banks, stock exchanges, microfinance institutions);
- The problem is not new for Ghana (crisis of 1970s) and its current non-performing loans ratio is higher than 15%.

To achieve these objectives, the following issues were dealt with:

1. Gathering of information about the guidelines of some financial institutions (IMF, World Bank, BCEAO, and of Ghana) and setting up of standards to provide the bank with maximum protection against problem loans and better dealing with the issue.

2. Assessment of the credit risk management processes of the Bank through a scanning of the general credit policy and procedure manual and interviews with the portfolio manager.

3. Sampling of some problem loans files, comparison between the actual practices and our standards and interpretations of similarities and dissimilarities.

The outcome of the study according to the points listed above was:

1. Despite the lack of universally adopted common principles the financial institutions have globally almost the same classification and provisioning systems in dealing with problem loans management. They recommend a four-tier classification as per the level of risk and, to each class a provision is required.

   However, the literature review showed that an effective problem loans management demanded a sound credit risk management before, during and after the loan was granted.

2. The Ecobank credit risk management assessment showed the following steps:

   - through a market analysis and targeting, the Bank identified profitable and safe industries,
   - a periodical follow up of the borrowers to have a dynamic vision of the risk linked to them,
   - a classification and provisioning of problem loans.

3. The comparison between our standards and the Bank's actual classification system and remedial strategies showed that ours were more severe than the Bank's one. The reasons were that:

   - Due to historical client relationship the Bank tends to be less severe with clients becoming bad.

   - Asymmetric information between the Bank and us also justifies different views in the assessment of the bad client situation.

Nevertheless, in order to improve the Bank's problem loans management practices, namely incentives system, collateral risk, industry risks, ownership of borrowing companies among others.

RESUME DE L'ETUDE

La présente étude avait pour but d'améliorer les pratiques de gestion des créances douteuses à Ecobank Ghana afin de réduire les pertes dues à ces prêts.

Les raisons de l'intérêt porté à ce sujet étaient les suivantes :

- nombre de crises financières mondiales étaient dues à l'importance des créances douteuses dans le portefeuille des banques notamment au Japon et en Chine entre autres.

- L'Afrique de l'Ouest est exposée à ce problème à cause de la concurrence au nombre croissant d'institutions financières (banques, bourses de valeurs mobilières, institutions de microfinance).

- Le Ghana n'est pas étranger au problème (crise des années 1970) et le taux actuel des créances douteuses du système bancaire ghanéen est supérieur à 15%.

Pour atteindre cet objectif, nous avons :

1. à partir des recommandations de certaines institutions financières (FMI, Banque Mondiale, BCEAO, Banque du Ghana), élaboré des principes qui selon nous sont à même de fournir une protection maximale contre les créances douteuses et en assurer une meilleure gestion.

2. Evaluer les processus de gestion du risque de crédit au sein de la banque à travers l'examen du manuel de politique de crédit et de procédures et d'interviews avec le gestionnaire du portefeuille de la banque.

3. Echantillonné certains dossiers de clients douteux de la banque et comparé le traitement de ces dossiers aux standards que nous avions établis en faisant ressortir les similitudes et les dissemblances.

Ce travail nous a permis d'aboutir aux résultats suivants en fonction des points cités plus haut :

1. Malgré l'absence de principes communs adoptés universellement, les institutions financières ont des systèmes de classification et de provisionnement globalement similaires en ce qui concerne les créances douteuses. Ils recommandent la classification des créances douteuses en quatre groupes en fonction du niveau de risque et, à chaque classe correspond un niveau de provisions à constituer.

Par ailleurs, il est ressorti de la revue de littérature qu'une politique de gestion efficace des créances douteuses passait inévitablement par un bon système de gestion du risque de crédit avant, pendant et après l'octroi du prêt.

2. L'évaluation des processus de gestion du risque de crédit à Ecobank Ghana a fait ressortir les phases suivantes :
   - à travers une analyse des marchés et un ciblage, la banque identifie des secteurs porteurs et peu risqués,
   - un suivi périodique de la situation des emprunteurs afin d'avoir une vision dynamique du risque couru,
   - un système de classification et de provisionnement des créances devenues douteuses ou litigieuses.

3. Il est ressorti de la confrontation entre nos recommandations et le traitement réel des dossiers par la banque que notre classification et les stratégies de recouvrement proposées apparaissaient plus sévères que celles de la banque. Les raisons de ces différences étaient :
   - La relation de clientèle entretenue par la banque avec certains de ces clients la freine dans son élan de sévérité extrême avec ces clients.
   - Une différence d'appréciation de la situation du client douteux compte tenu d'une asymétrie d'information entre la banque et nous.

Des recommandations ont été néanmoins faites en vue de l'amélioration des pratiques actuelles de la banque en matière de gestion de ses créances douteuses, notamment en ce qui concerne le système de motivation, les risques liés aux garanties fournies, l'exposition à un secteur d'activité donné, la nature des entreprises emprunteuses.

CHAPTER ONE: GENERAL INTRODUCTION

I. Background of the study

Since the information between banks (as lenders) and borrowers is asymmetric[1], lending is a risky activity. Banks need to monitor their borrowers to ensure the credit extended will be reimbursed in accordance with the pre-agreed terms and conditions.

The issue of problem loan remains crucial for economies of the world countries.

For instance, according to the Koizumi Cabinet[2], "One of the underlying causes of Japan's prolonged economic stagnation is the non-performing or bad loan problem". Professor Park (2002), states in a study[3] that according to the Financial Agency Services, the total sum of bad loans extinguished from the book for the entire banking industry of Japan since 1992 amounted to nearly 69 trillion yen, but the new bad loans cropped up faster than the ones retired. According to the same study, 13 large city banks of the country had written off 8 trillion yen of bad loans at the end of March 2002. However, their combined bad loans outstanding actually increased by 8.7 trillion yen over the previous year due to a faster accumulation of new bad loans. These figures show that problem loans have become a serious concern and finding a solution is becoming an emergency. The problem is not restricted to only Japan; it concerns the whole world.

According to the McKinsey Quarterly, in 2002, European banks were owed $900 billion of non-performing credits. The daily also noted that dealing with bad loans has become so worrying for banks that some of them have discerned the seeds for a new business. Some banks and other companies are now specializing in debt recovery. If banks, which are supposed to be debt specialists, start outsourcing the recovery of their bad debt, depositors may be frightened and doubtful about the safety of their deposits. In 2000, the weighted average cost of bad debt as share of total profits in Europe was 48%.

West Africa is also facing the problem of bad loans. There are three identifiable reasons that make the situation more critical than before: (1) the growing number of lending institutions, (2) the development of financial markets and stock exchanges and (3) the weaknesses in the Banking Supervision roles of Central Banks in the region.

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[1] For literature on asymmetric information refer to Akerlof (1970), Spence (1973), Stiglitz and Weiss (1981), Mishkin (2000).
[2] "*The Disposal of Non-Performing Loans and Its Potential Influence*", Study Project on the Potential Influence of Balance-Sheet Adjustments, June 28, 2001.
[3] "Bad loans and their impact on Japanese economy", See-Hark Park (2002).

The number of banks in West Africa has grown steadily the recent years. From 64 banks in 2000, the number of banks in the West African Economic and Monetary Union was 66 in 2002 and 74 in July 2004[4]. There is evidence that the growing number of banks will lead them to a competitive environment that will raise credit extension. In a heightened competition, more money will be lent with a moderate effect on banks credit policies. This occurrence will include the creation of problem loans.

The growth of lending activities to non-bank financial institutions, whose number is also significant (24 in 2004) will heighten competition in the lending sector and then make the credit conditions more flexible. Since the number of borrowers will increase due to probable decrease of credit requirements, the likelihood for banks to lend to bad borrowers will also increase. In that situation, prudent credit risk management systems and ability to manage problem loans will become critical successful factors.

Second, the deepening of the West African markets through the creation of the stock exchanges in West Africa[5] has given investors an alterative means for investment. Bank shareholders will therefore now require higher returns on their equity or shift their investments to the stock exchanges. This will constitute a fresh pressure on banks to, among others, grow their loan books for higher profitability, and hopefully increased shareholders' value.

Third, the weaknesses and inefficiencies of the Central Banks reflect in the relatively poor quality of the performance of the Banking Supervision function. In 2001, 15 of the 64 banks (being 23.4%) in West African Monetary Union did not comply with the risk coverage ratio, 23 banks (being 36 %) exceeded the limits of loans to managers and personnel of the bank and 29 banks were not complying with the ratio limiting the transactions with related groups or organizations[6].

Apart from the above-mentioned factors, which are common to most West African countries, there are note-worthy characteristics that are peculiar to the Ghanaian banking environment.

A survey by the IMF showed that Ghanaian banks were uncompetitive[7]. The institution highlighted that banks in Ghana were making "super profits" largely from treasury bills with little need to compete for lending business in private sector so far that a decline in interest rates yields involved a decline in banks profitability. Statistics from the Bank of Ghana

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[4] Central Bank of West African States (www.bceao.int).
[5] Ghana Stock Exchange (in Ghana), Nigeria Stock Exchange (in Nigeria), BRVM for the 8 WAEMU countries with an agency in each capital.
[6] Rapport Annuel, Commission Bancaire, 2002.
[7] *"Why Ghanaian banks behave uncompetitively?"*, The Ghanaian Times August 22nd and 24th, 2005.

confirm that the banking industry advances represented 28.6% and 32.5% of total assets respectively in December 2002 and December 2003 (being a rise of 35%). The rise in lending in 2003 was partially due to the decline in the T-bill yields and a fall in lending rates (lending rates declined from 34% in January 2003 to 32.5% in December 2003). If these trends continue banks will reduce their dependency on T-bills and increase lending, and most likely record increases in their bad loan portfolio, since, future non-performing loans is positively correlated with credit growth (Jiménez and Saurina, 2005).

The issue of problem loans is not new for Ghanaian banks. The Bank of Ghana shows that the percentage of non-performing loans to total loans amounted 12.8% and 11.9% in 1999 and 2000 respectively. After this marginal fall, non-performing loans ratio increased to 19.6% in 2001 and further to 22.7 by December 2002. In December 2003, it dropped to 17.9%. The "up-and-down" movement described by these figures is indicative that Ghanaian banks were yet to get a firm grasp of the bad loan menace.

Compared to the average of the Ghanaian banking industry, the non-performing loans ratio of Ecobank Ghana is relatively low. From 3.4% in 2002, the ratio rose to 4.2% in 2003 and dropped again to 3.9% in 2004.

II. **Purpose of the study**

The purpose of this study is to improve problem loans management practices at Ecobank Ghana Ltd. Critical related objectives are as follows:

- understand the Credit Risk Management Processes in the Bank
- assess the existing Problem Loans Management Systems of the Bank and compare these systems to best practices
- make recommendations to improve the Problem Loans Management Systems of the Bank.

III. **Research problem**

The problem to be solved can be summarized in the following question:

How can the losses due to problem loans be reduced at Ecobank Ghana Limited?

Related questions to ask include:

1. What are the Credit Risk Management processes of the Bank?

2. What measures are taken to prevent the creation of problem loans?

3.What are the existing Problem Loans Management Systems?

IV. Research methodology

In order to take a broader and complementary view of the research problem the triangulation methodology (Hussey and Hussey, 1997), a mix of both phenomenological and positivistic paradigms was adopted. Denzin (1970) defines triangulation as "the combination of methodologies in the study of the same phenomenon". He argues that the use of different methods by a number of researchers studying the same phenomenon should, if their conclusions are the same, lead to greater validity and reliability than a single methodological approach. The use of this methodology was also motivated by the mixed nature of the research questions requiring qualitative and quantitative data.

The methodology consisted of two steps:

- data collection
- data analysis and interpretation

1. Data collection

The data collection format depended on the kind of data to be collected.

a. Interviews

To answer the first two questions of the research problem (credit risk management processes and prevention measures) interviews were held with the Bank's credit portfolio analyst.

Information were also collected from the Group Credit Policy and Procedure Manual, which is the set of principles, procedures and controls that govern the entire credit risk management process.

b. Questionnaires

The last question was answered through questionnaires. Problem loans files were sampled and questionnaires containing closed questions were used to focus on key actions for addressing problem loans. A longitudinal study to follow the behavior of our variables throughout a period has been made.

2. **Data analysis and interpretation**

Data collected from the interviews were analyzed separately and compared to best practices. Both similarities and discrepancies with relevant explanations for the observed deviations as and when necessary were also analyzed and interpreted. Dissimilarities were analyzed and explanations why the Bank's practices were not complying with ours were provided.

V. **Significance of the study**

This study is significant because it deals with an issue banks are facing and will continue to confront in the future. According to the IMF, the average level of non-performing loans (NPLs) in Ghana is around 25% of the total loans. The institution also underlined that the definition of a non-performing loan in Ghana and the associated provisioning modalities were rather lax compared with other countries'. That means NPLs have been underestimated. At the same time, the Bank of Ghana in its last Financial Stability Report (FSR May 2005) was estimating the NPL ratio at 15.7%.

This shows the challenge of "Problem Loans" needs to be explored to set standards of definition because its definition is "intrinsically elusive and subjective" (Fuchita, 2004). There is also need to find strategies to manage them well and to work out.

The universal bank nature of Ecobank Ghana keeps the study of great importance despite the bank's relative performance. The NPL ratio of the bank is fluctuant (from 3.4% in 2002, to 4.2% in 2003 and 3.9% in 2004). For that reason, it is useful to direct this study in order to reduce and keep the ratio as low as possible.

This study has also a particular importance for the whole ECOBANK GROUP because it is a universal banking Group[8] characterized by an upward trend of development and a growing demand for money to develop the economies. The study will also provide a benchmark for other affiliates of the Group.

VI. **Limitations of the study**

Although this study has been completed successfully, there were practical difficulties. The time available was short for an in-depth understanding of the Ghanaian market, which is

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[8] Eeobank operates in 12 countries: Benin, Burkina Faso, Cameroon, Côte d'Ivoire, Ghana, Guinea, Liberia, Mali, Niger, Nigeria, Senegal and Togo.

relatively new to the writer. There were also difficulties to find relevant materials related to the field of study were also encountered.

Although the issue of problem loans has important accounting dimensions (provision and interest dealing), these were not analyzed in depth because the focus of the study is fixed on the lending practices in the Bank with the view to improving the problem loan situation.

VII. Structure

The study is structured as follows:

The next chapter (chapter 2) summarizes the literature on the problem loans issue. It gives an overview of the basic financial theories related to the subject and standards used as best practices in dealing with the issue.

Ecobank Ghana Credit Management Processes will be presented in the following chapter (chapter 3) to give the reader the general framework and techniques used to manage credit risks.

After that, the data collected will be analyzed and interpreted (chapter 4). In that part, we will present the data collection and analysis tools and show how the interpretations were done.

The data analysis and interpretation will be followed by recommendations to improve the credit risk management and lower loan losses (chapter 5).

The conclusion (chapter 6) will end the study with key deductions and thoughts.

CHAPTER TWO : LITERATURE REVIEW

This chapter reviews the body of literature on the subject matter of Problem Loans, and it is sub-divided into five parts:

- Part one: It mentions some links between the reality of problem loans and basic economic theories such as asymmetrical information, adverse selection, moral hazard and early warning systems.

- Part two: This provides some country by country insights by looking at bank crises faced by Japanese, Chinese and Latin America banks and learn lessons from them.

- Part three: This part shows the role played by supervisors and external auditors in identifying problem loans.

- Part four: The focus is on identifying the defining features of global acceptable practices for managing problem loans.

- Part four: In this final part, the literature review distills a core of recommendations as constituting the framework of best practices.

I. Basic theoretical framework

I. Problem loans and asymmetrical information

Although the problem of economics of information and the special issue of asymmetric information was debated by early economists such as Adam Smith (1776), Simonde de Simondi (1814), John Stuart Mill (1848), Alfred Marshall (1890) and Max Weber (1925), they did not mention the term "asymmetrical information". The most famous paper on the topic was "The market of lemons" of Akerlof (1970). In this study, Akerlof notes that the owner of a "lemon" (used car) knows more about its quality than any potential buyers. The example of used cars therefore involves asymmetric information. According to Akerlof, asymmetric information exists when one side of the market possesses information lacked by others players in that market. Other authors referred to other markets in which asymmetric

information operates. Spence (1973) applied information asymmetry to the labour market, stating that a job applicant knows more about his skills than the employer. Another example relates to an insurance company with a relatively inadequate knowledge about a potential client's health. Stiglitz and Weiss (1981) are those who emphasized on credit rationing as consequence of asymmetric information. For them there is asymmetrical information between banks being the less-informed principals and borrowers being the well-informed agents, referring to the agency theory developed by Jensen and Meckling (1976). This model is quite similar to the theoretical one of Jaffee and Russell (1976) in which imperfect information about the investment to be made leads to credit rationing in a loan market in which lenders are less informed than borrowers on the likelihood of default and the riskiness of the investment. This last example leads to the fear for the loan to become bad and the banker not to recover the principal and interest of the money lent. The Minsky theory of investment finance and financial instability model illustrates that as well. Minsky (1982, 1985) assumes that bank financing is needed in an investment project and the decision of investment is made under uncertainty. Once the decision to invest is taken and the project financed, the principal and the interest are supposed to be repaid with the expected revenues of the investment. If then an external shock occurs, the recovering of the bank financing becomes doubtful and the loan becomes bad.

Asymmetric information between the bank (as lender) and the investor (as borrower) about the actual characteristics of the investment being made, coupled with the instability of the market and global environment lead to problem loans management. Therefore, an effect on both factors is supposed to overcome problem loans. Assuming the hypothesis of the efficiency of the market, the only significant factor worth considering is information asymmetry. This leads us to adverse selection and moral hazard, both consequences of the attempt to overcome information asymmetry.

2. <u>Problem loans, adverse selection and moral hazard</u>

"The market of lemons" contains both good and bad quality used cars and Akerlof shows that the awareness of potential borrowers will lead them to assume that the percentage of bad quality used cars is high. That will depress the price of used cars in general and drive good quality used cars out of the market. This phenomenon is defined by him as adverse selection.

In the Stiglitz and Weiss model, prices can act as a screening device to distinguish bad borrowers from good ones in the same market. According to them raising the interest rate can

help select good borrowers but only up to a certain limit of interest rate r* (figure 1). Above that interest rate, the adverse selection operates and the market starts attracting bad borrowers with high risk. Another effect of using interest rate as screening device is that at high interest rates, borrowers are more likely to change their behavior and invest in high risk projects (with high expected returns). That change in the behavior is known as moral hazard.

Figure 1: Bank optimal rate

Expected returns

r^*

bank optimal rate

r
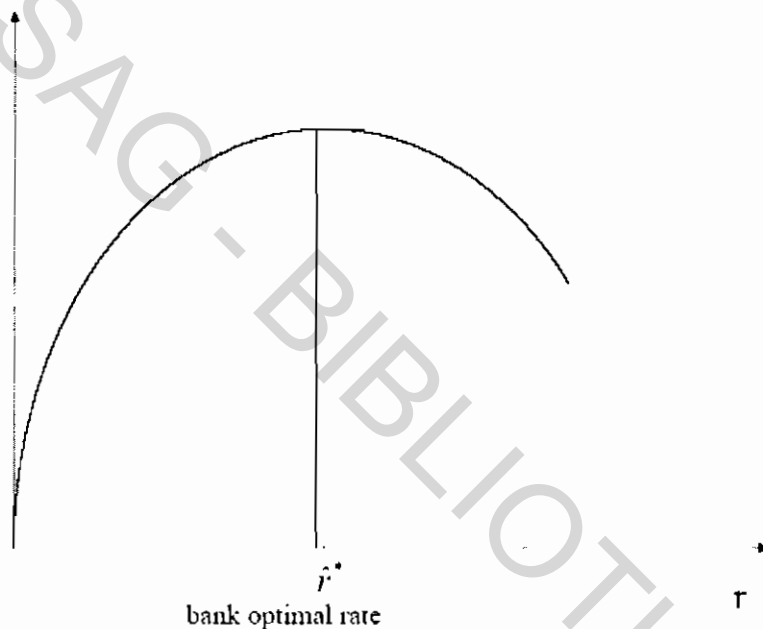
Source*: Credit Rationing in Markets with Imperfect Information,*
Stiglitz and Weiss (1981)

Williamson (1986) developed a model of credit rationing where borrowers are subject to a moral hazard problem. In his model some borrowers receive loans and others do not.

In the same vein, according to Claus and Grimes (2003) adverse selection increases the likelihood that loans will be made to bad credit risks, while moral hazard lowers the probability that a loan will be repaid. Their model of credit rationing to avoid problem loans is slightly different from Williamson's one. They identify two forms of credit rationing. The first is to give some applicants a smaller loan than they applied for at a given interest rate. The second is not to give other applicant a loan at all even if they offered to pay a higher interest rate. Edelberg (2004) studied tested adverse selection and moral hazard in consumer loan markets. She found evidence of adverse selection, with borrowers self-selecting into contracts

with varying interest rates and collateral requirements. She also found evidence of moral hazard such that collateral was used to induce a borrower's effort to repay their debts. Her conclusion was that loans terms had a feedback effect on behavior.

The efforts to solve the problem of asymmetric information lead authors to adverse selection and moral hazard, both factors that higher the probability to face a problem loan. Interest rate appears to be inefficient in selecting good borrowers from bad ones as well as all other loan terms such as collaterals. Is the optimal contract between a lender and a borrower a debt contract in which the lender only monitors in the event of default as concluded by Williamson? We do not think so because the lender's concern is to prevent from problem loans and not to support it.

3. Problem loans and early warning systems

In order to prevent borrowers bankruptcy, banks developed insolvency-forecasting models. Altman (1968) was the first to design an insolvency-forecasting model based on multiple linear discriminant analysis. He studied five financial ratios of 66 American companies and built a Z-score function to forecast the defeasance of a company. He studied 22 ratios (liquidity, solvency, gear ...) taken from the most frequently used by American banks to assess the creditworthiness of companies.

His model was as follows:

$Z = 0.012\ X_1 + 0.014\ X_2 + 0.033\ X_3 + 0.006\ X_4 + 0.999\ X_5$

where X1 = Working capital / Total of assets

X2 = Reserves / Total of liabilities

X3 = EBIT[9] / Total of assets

X4 = Market value of shares / Total of debts

X5 = Turnover / Total of assets

The forecasting model was reliable at 80 % for only one and sometimes two years. Above that timeline the model became reliable only at 40%.

Another study on a sample of 111 companies by Altman, Haldeman and Narayanan (1977) led to the Zeta model. The Altman model was improved later by Conan and Holder (1979) and by the Banque de France (1983), which build models specific to industry sectors.

Such models are highly reliable since they are built from companies operating in the same activity sector and have similarities of financial structure.

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[9] Earning Before Interest and Taxes

Other methods were used to forecast insolvencies such as logistic regression (Boisselier and Dufour); a neuronal approach was also developed (Beauville and Zollinger, 1995).

Most of these models were assuming that a scanning of a company's financial statements three to five years before could predict its failure. Other authors criticized these models arguing that other non-financial information were relevant in credit rating models (Grunert, Norden and Weber, 2002) and that banks were reluctant to let them drive by a mechanist model (Treacy and Carey, 1998).

Despite all the critical notes, early warning systems are still growing since the Basel 2 Committee encouraged banks to build Internal Ratings-Based (IRB) systems. Those systems are based upon the banks' own estimations of credit risk. The risk components include measurements of the probability of default (PD), loss given default (LGD) and exposure at default (EAD). It is important to underline that those rating systems now integrate both quantitative and qualitative information and even if they cannot eliminate problem loans, they remain a key and relevant tool of decision-making.

All these models were applied on banks lending activities to provide a solution to the issue of problem loans. Unfortunately, banks still face problem loans. Information asymmetry will always exist since a borrower's financial soundness can be affected by an external shock that may occur (Minsky, 1982 & 1985). Interest rate has appeared to be an ineffective screening device as insolvency forecasting models and IRB systems only provide a probability of failure but cannot ensure whether the failure will occur. Williamson's conclusion that the optimal contract between a lender and a borrower is a debt contract and the lender only monitors in the event of default can also not avoid problem loans and loan losses.

II. Lessons from world banks crises

The issue of problem loans has arisen as one of the most important sources of the "lost-decade" in Japan (Fukuda and Koibuchi, 2005). Whereas more than 60% of total assets of banks are loans to customers, the safety of those loans becomes very critical and relevant for the banking system stability. Many authors commented on the issue of problem loans by considering the measures taken by the Japanese government to overcome the problem. They also look at the experiences of other countries.

In his paper on the Japanese banking crisis, Ueda (1998) affirmed that the definition of bad loans has changed over time and has been a source of confusion. Initially, banks were

reporting only Non-accrual Loans. Later, they added Past Due Loans and then Restructured Loans to the list. He underlined inefficient or lax bank management as a cause of bad loans problems but emphasized the role of the real estate industry. He found that in 1990s banks with a high exposure to real estate industry suffered more from bad loans problems.

Nishimura et al (2001), in their critical paper on the Koizumi Cabinet policies regarding the disposal of Japanese financial institutions' bad loans, raised the following issues:

- Risk management skills: in their view the existence of bad loans is not a problem in itself as bad loans are inevitable when banks provide firms with credit. The financial institutions must practice adequate risk management.
- Dynamism: the risk management policies must be adjusted to match the industry structure changes. To evaluate the financial risks they assume through lending, financial institutions must also have accurate information on real estate prices when these are used as collateral.

According to the IMF (1999), the slow speed of restructuring in Japan is in part due to the extensive ownership links among banks, other financial intermediaries, and corporations.

The role of Asset Management Companies (AMCs) in dealing with problem loans has been commented on by other authors.

Klingebiel (1999) thinks banks should be better placed to resolve Non-Performing Loans (NPLs) than centralized AMCs as they have the loan files and some institutional knowledge of the borrower. She adds that leaving the NPLs in the banks' balance sheets may also provide better incentives for banks to maximize the recovery value of bad debt and avoid future losses by improving loan approval and monitoring procedures.

Her cross country experience showed that the countries that transferred high percentages of their total assets to AMCs, namely Ghana, Mexico and Philippines (figure 2) are the ones that faced recurrent problems and did not achieve their narrow objectives. Even the achievement of their broader objectives was unclear (cases of Ghana and Philippines) and sometimes a failure (case of Mexico).

Figure 2: Assets transferred to AMCs
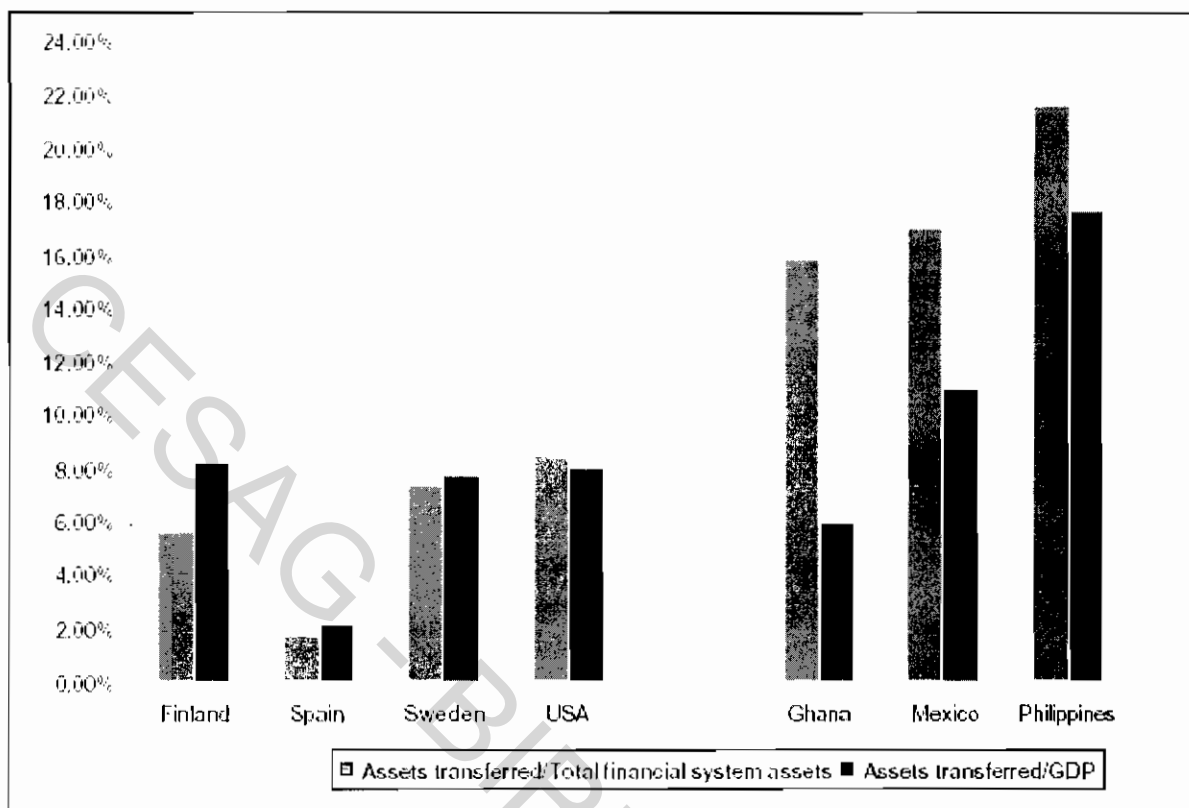
Source: Kinglebiel (1999)

Table 1: Evaluating the Country Cases

	Type-Objective of AMC established	Corporate restructuring asset disposition			Health of banking system	
		Share of assets disposed	Have AMCs achieved their narrow objective	Recurrent problems	Growth of real credit	Have AMCs achieved their broader objectives
Finland	Restructuring	-64	Unclear	No	Negative	Unclear
Ghana	Restructuring	Not applicable	No	Yes	Positive	Unclear
Mexico	Rapid Asset Disposition	0.1	No	Yes	Negative	No
Philippines	Rapid Asset Disposition	50	No	Yes	Positive	Unclear
Spain	Liquidation	Majority	Yes	No	Positive	Yes
Sweden	Restructuring	86	Yes	No	Negative	Unclear
USA	Liquidation	98	Yes	No	Negative	Unclear

Source: Kinglebiel (1999)

The role and independence of AMCs has also been pointed out in China. Bartel and Huang (2002) disagreed with China's dealing with State Owned Banks' (SOB) bad loans problem. For them the establishment of AMCs to deal with China's bad loans problem was a good foundation upon which a strong reform of the banking system can be built. Nevertheless, they pointed out the lack of independent bank governance, and also underlined that creating AMCs could lead to a moral hazard problem of encouraging banks to new low quality loans. In their view, identification of bad loans is not trivial in any banking system. The necessary information to distinguish a good loan from a bad one is imbedded at the branch level, oftentimes with the responsible loan officer.

The identification problem is magnified in China because the standard international loan classification system was adopted only recently.

Berger and DeYoung (1997) studied problem loans and cost efficiency in commercial banks. They tested four hypotheses regarding the relationships among loan quality, cost efficiency, and bank capital. Their data suggested that: a. problem loans precede reductions in measured cost efficiency; b. that measured cost efficiency preceded reductions in problem loans; and c. reductions in capital of undercapitalized banks precede increases in problem loans. They concluded that cost efficiency might be an important indicator of future problem.

Cavallo and Majnoni (2001) studied a sample of 1176 large commercial banks, 372 of which were from non-G10 countries, over the period 1988-1999. They found "robust evidence" that the relationship between loan loss provisioning and banks' pre-provision income was positive for G10 banks and negative for non-G10 banks. They concluded that non-G10 countries provisioned too little in good times and were forced to increase provisions in bad times. This view is seconded by Jiménez and Saurina (2005), who suggest banks to provision in good times for the additional risk added to the portfolio due to credit growth. Actually, they found evidence of a positive relation between rapid credit growth and future non-performing loans of banks. According to them banks could use the reserves cumulated in boom periods to cover loan losses in bad times.

Laeven and Majnoni (2002) noted that many banks tended to delay provisioning for bad loans until too late, when cyclical downturns had already set in. According to them bankers created too little provision in good times and then were forced to increase them in economic downturns. They also found a considerable difference in patterns followed by banks around the world.

Dahiya, Puri and Saunders (2003) analyzed the effects of loan sales on both the borrower and the lender. They found that 42% of the firms whose loans were sold filed for bankruptcy within 3 years of the announcement of a loan sale by their bank lender. On the other hand, the sale of a loan by a bank carries no significant information and had no impact on its stocks value; although loan sales appear to be made by generally weaker banks.

III. Role of Supervisors and External auditors in identifying problem loans

In summer 1993, Banco Español de Crédito (Banesto), the Spain fourth-largest bank in terms of deposits issued stocks for the global amount of 93 billion peseta ($645.3 million). These stocks were worth almost nothing six months later. In December, the Bank of Spain seized control of Banesto and fired its management, trying to head off the run on deposits.

Two thrift institutions were charged by analysts for having misled the investors of those stocks:

- *Spain's central bank* approved the rights issue without a thorough inspection of the bank's accounts. Bank of Spain also did not disclosed that Banesto had purchased 30 percent of its own stocks despite the bank regulation that forbids banks to own more than 5 percent of their own shares.

- *Price Waterhouse*, the bank's external auditor, only looked at the large loans without doing even a sampling of the smaller loans and disregarding that different types of loans have different rates of non-performance. The positive results of that audit were often cited by Banesto in presentations it made before the rights issue.

This example, among others, shows how important can be the role of supervisors and external auditors in the stability of banking and financial system.

This section is divided into two parts:

The first one demonstrates that, if well applied, any banking supervision embodies the key elements to prevent from and identify problem loans.

The Bank for International Settlements (BIS) through the Basel Committee on Banking Supervision (BCBS) has performed 25 "core principles"[10] that should be the bases of an effective banking supervision. Bank regulations vary from one country to another as do the domestic circumstances. The core principles are seen to be the minimum standards any

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[10] The exhaustive list of the 25 core principles is available in appendix 2.

supervisory authority should comply with. For that reason focus will be put on the core principles to show the contribution of supervisors in identifying problem loans.

The second part of this section shows the capability of a well conducted external audit mission to identify problem loans. In the core principles, reference is also made to external auditors as key role players in the financial stability of the banking system and the problem loans issue.

1. The role of banking supervision

Twelve (12) core principles[11] make reference to problem loans issue generally. They can be gathered in three groups dealing with the three following items:

> - general advices to prevent the bank from problem loans (CP11 to 15)
> - checkpoints, criteria, ratios to respect (CP7 to 10)
> - controls and coercion measures (CP16, 19 & 22)

a. General advices

From core principle 11 to 15, the following functions of the banking supervision are highlighted:

- Control over banks organisation to ensure they have effective information systems and risk management processes to monitor all kinds of risk (country, transfer, market risks)
- supervisory authority must be sure appropriate reserves and provisions are held against such risks where they may occur
- supervisors must ensure banks have strict "know-your-customer" rules to avoid criminal activities (i.e. money laundering)
- banks audit function is assessed to make certain the internal control is sound and periodically reviewed to meet the changing in the bank's activities

b. Checkpoints, criteria, ratios

Areas of interest of the supervisor in connection with problem loans specifically are dealt with in 4 core principles (CP7 to 10) and can be summarized as follows:

- Evaluation and periodical review of policies, practices and procedures of loans granting and their ongoing management

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[11] The 12 core principles are CP 7 to 16, 19 & 22.

- evaluation of policies and procedures of assessment of the quality of assets and loans loss provisioning and reserves including asset grading and classification
- limits are set by supervisor to avoid credit concentration (i.e. large credits granted to single or related borrowers) and prevent banks from great exposures

The items listed above are guidelines. Supervisors have the responsibility to set quantifiable ratios and criteria to be followed by banks.

c. *Controls and coercion measures*

In order to enforce its recommendations, supervisor has the right to:
- Control banks both on-site and off-site to verify the reliability of the information provided. This supervision can be conducted either by supervisor's staff or by external auditors and also aims to provide any additional information needed to better assess banks
- take remedial actions to address problems that occur when banks fail to meet requirements
- revoke the banking license in case of extreme violation of regulations

2. The contribution of external auditors

The 19th core principle stipulates that "*Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors*". The reference made to external auditors shows:
- the confidence of supervisors in external auditors
- the key role played by external auditors in the validation of information provided by banks and/or collected by supervisors.

As for the supervisors, external auditors will have to give an opinion on the bank's compliance with regulations generally and specific ratios more precisely. This opinion shall cover all areas of banks activity including the portfolio structure, its quality and the accuracy of the classification and provisioning system for problem loans.

IV. "Problem loans", "Bad loans" and "Non-performing loans": definitions and recommended practices

There is no harmonization of asset classification rules at an international level. The definition of problem loans or asset impairment varies across countries (Lis, Pagés and Saurina, 2000). The differences among countries increase when examining loan loss provisioning rules and practices (for illustration see appendix 1: Loan loss provisioning in selected emerging markets). "Problem loans" is used synonymously with "Non-Performing Loans", "Problem Loans" or "Bad Loans".

Fuchita (2004) distinguished "Bad Loans" from "Bad Loans Problems". While arguing that the narrowest definition of "Bad Loans" might be "a loan which fails to meet certain obligations to pay interest and/or principal", he said it is bad loan problems we have to focus on instead of bad loans per se. This meets our view since we are working on "Problem Loans Management Practices" and feel no need to emphasize on "Problem Loans" definitions.

In this part we will present the practices recommended by institutions like the World Bank, the International Monetary Fund, the West African Monetary Union and the Bank of Ghana for a successful dealing with problem loans.

The next section presents standard practices recommended by the World Bank, the International Monetary Fund, the West African Monetary Union and the Bank of Ghana for acceptable management of problem loans.

1. World Bank

According to the World Bank[12], the five basics that a bank must have in order to successfully deal with problem loans are:

1- A validated and properly functioning system of credit quality control and asset classification

2- The needed reserves to write off all portions of the identified losses

3- The removal of these assets from the line organization which underwrote them and their transfer to a specially trained group of collectors

4- The usage of a well-functioning legal system to help force collection

5- The stoppage of making, or renewing, bad loans

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[12] Richard H. Daniel, *"An Alternative to Government Management Companies: The Mellon Approach"*, World Bank Conference on Corporate Restructuring: International Best Practices, March 22-24, 2004.

The recommended loan classification and provisions requirements of the World Bank are as follows:

Classification	Loan Classification System	Provision Requirement
Standard, or pass	When debt service capacity is considered beyond any doubt. In general, loans and other assets fully secured (including principal and interest) by cash or cash-substitutes (e-g banks certificates of deposit or treasury bills and notes) are usually classified as standard, regardless of arrears or other adverse credit factors.	General loss reserve, if disclosed 1 – 2%
Specially mentioned, or watch	Assets with potential weaknesses that may, if not checked and corrected weaken the asset as a whole or potentially jeopardize a borrower's repayment capacity in the future. This, for example, includes credit given through an inadequate loan agreement, a lack of control over collateral, or without proper documentation. Loans to borrowers operating under economic and market conditions that negatively affect the borrower in the future should receive this classification. This applies also to borrowers with an adverse trend in their operations or an unbalanced position in the balance sheet, but which have not reached a point where repayment is jeopardized.	Specific provision 5 – 10%
Substandard	This classification indicates well-defined credit weaknesses that jeopardize the debt service capacity, in particular when the primary sources of repayment are inadequate and when the bank must consider other sources of repayment such as collateral, the sale of a fixed asset, refinancing, or fresh capital. Substandard assets typically take the form of term credits to borrowers whose cash flow may be not sufficient to meet currently maturing debts or loans, advances to borrowers that are significantly undercapitalized. They may also include short-term loans and advances to borrowers for which the inventory-to-cash cycle is insufficient to repay the debt at maturity. NPAs[13] that are at least 90 days overdue are normally classified as substandard, as are renegotiated loans and advances for which delinquent interest has been paid by the borrower from his own funds prior to renegotiations and until sustained performance under a realistic repayment program has been achieved.	Specific provision 10 – 30%
Doubtful	Such assets have the same weaknesses as the substandard assets, but their collection in full is questionable on the basis of existing facts. The possibility of loss is present, but certain event that may strengthen the asset defer its classification as loss until a more exact status may be determined. NPAs that are at least 180 days past overdue are also classified as doubtful unless they are sufficiently secured	Specific provision 50 – 75%
Loss	Certain assets are considered uncollectible and of such little value that the continued definition as bankable assets is not warranted. This classification does not mean that an asset has absolutely no recovery or salvage value, but rather that it is neither practical nor desirable to defer the process of writing it off, even though partial recovery may be possible in the future. NPAs that are at least one year past overdue are also classified as losses, unless such assets are very well secured.	Specific provision 100%

Loans classified as 'pass' and 'watch' are reviewed twice per year and loans classified as 'substandard', 'doubtful' and 'loss' are reviewed at least each quarter.

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[13] Non-Performing Assets.

2. **International Monetary Fund (IMF)**

For the IMF, the existence of both financial and non-financial early warning systems plays an important role in problem loans management since they may prevent the bank from losses if actions are taken in time to develop a remedial strategy. In addition, loan documents must contain clauses that allow the bank to examine the books of the borrower. There are two essential work-out strategies recommended depending on the assessment of the problem:

- If the problem area can be corrected, banks are encouraged to restructure the loan by increasing collateral, revising repayment and/or changing management.
- If the problem area cannot be corrected, banks must exit the business by selling collateral and taking legal action.

The loan classification of the IMF is quite similar to the World Bank's one but with the following classes:

- Sound
- Weak
- Substandard
- Doubtful
- Loss

3. **West African Monetary Union**

The WAMU Banking Commission defines 'impaired loans[14]' as all loans that are not repaid under the pre-agreed terms and conditions. It recommends that such loans must be clearly identified and isolated from the bank's books for a specific treatment. All loans with either high or low risks of non-recovery must be watched and an internal reporting system to the Managing Director must be initiated. This will foster Senior Management involvement and guidance in the close monitoring and management of the stressed accounts to lessen the financial effects on the bank.

Loans classification system and provision requirements differ as the case may be:

- *Direct risks or signatory commitments taken on the State and its fellows:* optional provision.

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[14] The original french term is 'créances en souffrance'

- *Risks guaranteed by the State*: it is suggested, but not demanded, to make provisions up to the amount of the guaranteed debt (principal and interest) over a maximum period of 5 years, if the risks covered are not taken into account in the State budget.
- *Private risks not guaranteed by the State:* the following table summarizes the loans classification and provision requirements.

Classification	Loan Classification System	Provision Requirement
Unpaid debts	Debts overdue for a period not exceeding 6 months and that have not been extended or renewed.	Optional
Immobilized debts	Debts overdue for a period not exceeding 6 months and the repayment is unlikely due to reasons beyond the borrower's control. Debts restructured and that the repayment terms are respected.	Optional
Doubtful or contentious debts	Debts overdue or not but presenting probable or certain risks of part or full non-recovery. Debts that have registered at least one unpaid of at least 6 months. Debit accounts without any creditor movement for a period over 3 months. Debit accounts without any significant creditor movement for a period over 6 months.	- Assets not secured: 100% provisioning - Assets secured by collateral: optional provision for the first 2 years, 50% the 3rd year and 100% the 4th year. -
Uncollectible debts	Assets considered uncollectible after the bank has given up all efforts either amicably or legally.	Uncollectible debts are accounted as losses for their full amount.
Country risks	Off-balance sheet debts and undertakings on public and private debtors	Provisioning is let at the discretion of banks but interests must be fully provisioned if due over 3 months.

4. Bank of Ghana

The Bank of Ghana guidelines concerning loans classifications are as follows:

Category	Loan classification system	No. of days of delinquency	Provision
Current	Advances in this category are those for which the borrower is up to date (i.e. current) with repayments of both principal and interest. Indications that an overdraft is still current would include regular activity on the account with no sign that a hardcore of debt is building up.	0 – less than 30	1%
Other loans especially mentioned ("OLEM")	Advances in this category are currently protected by adequate security, both as to principal and interest, but they are potentially weak and constitute an undue credit risk, although not to the point of justifying the classification of substandard. This category would include unusual advances due to the nature of the advance, customer or project, advances where there is a lack of financial information or any other advance where there is more than a normal degree of risk.	30 – less than 90	10%
Substandard	Substandard advances display well-defined credit weaknesses that jeopardise the liquidation of the debt. Substandard advances include loans to borrowers whose cash flow is not sufficient to meet currently maturing debt, loans to borrowers which are significantly undercapitalized, and loans to borrowers lacking sufficient working capital to meet their operating needs. Substandard advances are not protected by the current sound worth and paying capacity of the customer. Non-performing loans and receivables which are at least 90 days overdue but less than 180 days overdue are also classified substandard. In this context advances become overdue when the principal or interest is due and unpaid for thirty days or more.	90 - less than 180	25%
Doubtful	Doubtful advances exhibit all the weaknesses inherent in advances classified as substandard with the added characteristics that the advances are not well-secured and the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the advance, its classification as in estimated loss is deferred until its more exact status may be determined. Non-performing loans and receivables which are at least 180 days overdue but less than 360 days overdue are also classified as doubtful	180 – less than 360	50%
Loss	Advances classified as a loss are considered uncollectable and of such little value that their continuation as recoverable advances is not warranted. This classification does not mean that the advance has absolutely no recovery value, but rather it is not practical or desirable to defer writing off this basically worthless advance even though partial recovery may be effected in the future. Advances classified as a loss include bankrupt companies and loans to insolvent firms with negative working capital and cash flow. Banks should not retain advances on the books while attempting long-term recoveries. Losses should be taken in the period in which they surface as uncollectible. Non-performing loans and receivables which are 360 days or more overdue are also classified as a loss.	360 and above	100%

V. <u>Soundness problem loans management criteria</u>

Up to this point the literature review has focused on some global perspectives and factors relating to the internal workings of corporate systems and how they impact on loans management. Despite the absence of consensus on internationally agreed standards, significant strands of thought run through the prescriptions of leading financial institutions. From the preceding literature review, it appears a sound Problem loans Management system is founded on three main pillars, namely:

- *The credit risk management*: it constitutes the framework within which credit applications are processed and as aforesaid it can sometimes be chargeable for problem loans occurrences.

- *Loans classification and provisioning*: it is particularly important because it provides a mechanism to classify loans by degree of riskiness and develop specific remedial management strategies.

- *Remedial management*: Key actions to be made and strategies to be developed at each stage of the remedial management process.

1. <u>Credit Risk Management</u>

These are some of the criteria a good Credit Risk Management System must have as recommended by the ICBC[15]:

1. Pre-lending controls:
   - ➢ Detailed credit policy and management rules
   - ➢ Internal Rating System to assess credit risk
   - ➢ Centralized review of customers credit limits
2. On-lending controls:
   - ➢ Authorization management
   - ➢ Approval of credit business
3. Post-lending controls:
   - ➢ Credit monitoring
   - ➢ Field inspection

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[15] Industrial and Commercial Bank of China, Annual Report 2003

2. Loans classification and provisioning

A good loans classification system looks like the following one, regardless of the names given to the different classes:

Classification	Loan Classification System	Provision
Class A	Debts fully secured by cash collateral even if overdue. Borrowers are up-to-date in repayments. Debts above suspicion overdue for less than 1 month.	1% - 2%
Class B	Debts overdue for a period between 1 month and 3 months.	10% - 15%
Class C	Debts overdue for a period between 3 months and 6 months.	25% – 30%
Class D	Debts overdue for a period between 6 months and 12 months.	50% – 75%
Class E	Debts overdue for a period above 1 year.	100%

In the above classification system does not emphasize on the perception of future events concerning the borrower's financial situation by the analyst, as did many organizations in their recommendations. We considered that appreciation of future events could vary from person to person and can lead to different classifications of the same asset.

Intervals have been provided for provisions so that the problem loans officer can make different levels of provision for assets classified in the same category but with different probabilities of failure.

3. Remedial management

We consider that remedial management strategies depend on assets classification. At each stage, a new strategy must be deployed.

Classification	Remedial management strategies	Officer in charge
Class A	Maintain and improve relationship. Friendly remind the borrower (if debt is overdue).	Relationship Officer
Class B	Require more collateral to secure the loan Require a short-term repayment schedule from the borrower or restructure the loan if the borrower is not likely to repay within 3 months.	Relationship Officer
Class C	Require a short-term repayment schedule from the borrower or restructure the loan if the borrower is not likely to repay within 6 months.	Remedial Manager
Class D	Exit the business by selling collateral and/or taking legal action.	Remedial Manager
Class E	Exit the business by selling collateral and/or taking legal action.	Remedial Manager

The proposed remedial strategy may appear as rigid but two main reasons founded our choice:

1. Loan recovery is extremely time-consuming especially when the borrower is unwilling to repay. It may also draw staff members' attention away from other tasks and more lucrative businesses.

2. The long follow-up process involving telephone calls and transportation fees particularly when the borrower is not in the same geographical area can make the loan recovery be very costly for the bank. Attorney fees can also burden the bank especially when it refers to a legal counsel in collecting the money.

CHAPTER THREE: CREDIT RISK MANAGEMENT PROCESSES IN ECOBANK GHANA LTD

Problem loans are at the end of the credit channel. Before a loan becomes bad, it needs to be granted. Moreover, as we referred to so far, the poor quality of a loan is sometimes due to factors not attributable to the lending bank such as adverse selection and moral hazard (Stiglitz and Weiss (1981)) or any other external shock that may alter the borrower's ability to repay the loan (Minsky, 1982 & 1985). Nevertheless, there are cases where the way banks grant and monitor credits can be responsible for the bad loan portfolio. In other terms, weak credit risk management systems can also be sources of problem loans (Nishimura and al, 2001).

For this last reason, it was essential to overview the credit risk management process of the Bank in order to capture the framework of the bad loans management before scanning the problem loans files.

For competitive and confidential reasons, only significant details related to the credit management processes are revealed here. Yet, we put enough information to overview the process and give an opinion on it.

This chapter is divided in two parts:

- the first part deals with the credit management process

- the second explains the problem loans management.

The information in this chapter is mostly based on the Group Credit Policy and Procedure Manual (GCPPM) and interviews with the portfolio manager.

I. Credit management process

Ecobank Ghana Limited credit management processes can be summarized in three main stages:

-   credit initiation
-   documentation and disbursement
-   credit administration

1. <u>Credit initiation</u>

The credit initiation is a process that starts from a market analysis and ends at the credit application approval. The steps of the credit initiation are listed below:

- ***Surveys and industry studies:*** Relationship Officers scan the market and economic sectors to identify key players and potential business for the Bank. In the same vein, industries with high potential of growth that can be good business for the Bank are also listed.

- ***Risk Asset Acceptance Criteria (RAAC):*** for each industry, criteria are designed to guide the relation with both industry and clients in order to limit the level of exposure at credit risk. RAACs applied to industries include both quantitative and qualitative information such as net sales, net profit, years of experience in the business and the quality of corporate governance.

- ***Prospect lists:*** some prospects (companies and individual customers) identified as the main role players are short listed in accordance with the industry studies and the minimum risk criteria. This prospect list is ranked in order of preference.

- ***Customer solicitation:*** at that stage, although the primary source of target is the prospect list, the initiation of a credit comes either at the bank request in the frequent contact with existing customers or at the clients request if they have a need for financing.

- *Negotiation:* the relationship officer identifies the financing needs of the borrower and gathers background information such as the latest financial statements, project details, projections over the loan life. This information will allow the officer to check whether the risk is bearable by the Bank and its compliance with the bank's targets.

- *Presentation:* the conformity of information given with the market and industry analysis is the reliability of the information once again verified by consulting other sources. A draft of the credit application (CA) is prepared in conformity with the GCPPM and I consideration of the market and industry analysis by the account officer based on information collected.

- ***Credit committee approval:*** a copy of that CA is submitted to each member of the credit committee. The members review and approve submission of the final CA.

- ***Control and reporting requirements:*** the final CA package is submitted to the credit committee with highlights on the credit exposures of the bank.

- *Advise to customers:* once the credit is approved, the customer is advised in writing with details concerning the terms and conditions and with the statement that the credit can be subject to review, modification or cancellation at the Bank option.

2. **Documentation and disbursement**

The documentation and disbursement refers to the compliance of documents provided with the law applicable and the requirements of the Bank's legal department. Documentation provided must satisfy the Bank's legal department and afford maximum protection to the Bank.

The documentation is periodically reviewed to keep them in fine with ever-changing legal systems and practices.

The Legal department is consulted before making any compromises with the customer. Any amendments are done in consultancy with the legal department.

Once the credit application satisfies all these conditions, a thorough analysis is done and if the application complies with the Bank's conditions, instruction is given to the Credit administration for disbursement.

3. **Credit administration**

The credit administration refers to the credit support, control systems and other practices necessary for the effective monitoring of credit risks taken by the Bank.

Some of the important points of the credit administration are:

- Control of Credit files.
- Safekeeping of credit and documentation files.
- Follow-ups for expirations of essential documents like CA's and insurance.
- Control of availments and excesses over approved lines.
- Monitoring of collateral inspections, site visits and customer calls.
- Monitoring of repayments under term credits.
- Reporting: the portfolio is periodically reviewed to make sure that the names tiered are still complying with the risk acceptance criteria.

II. **Problem loan management**

When the time for repayment comes, two scenarios may occur:

1. the loan is repaid (principal and interest) under the pre agreed terms and conditions

2. the borrower fails to make the repayment of both or part principal and interest. In such case the loan then becomes a problem loan and a new process is then triggered. A loan

can become a problem loan before its maturity due to the disclosure of any information questioning the borrower's ability to repay (case of cross default for example).

In respect of the GCPPM, three main stages can be defined in the bank's dealing with problem loans:
- the early warning systems
- the classification and provisioning
- the remedial management

1. Early Warning Systems

They refer to the ability of the Bank to anticipate, detect, recognize and report problems as early as possible so that prompt corrective actions can be taken to avoid problem loans. In order to achieve this objective, the Bank has built three main internal rating systems:
- Obligor Risk Rating (ORR): The rating attributed to the obligor applying for a credit.
- Portfolio Risk Rating (PRR): The rating attributed to a group of related companies, which has stakes in other companies. The PRR of a group is derived from the ORR of the companies in its portfolio.
- Facility Risk Rating (FRR): the structure, security and tenor of a facility inform the assignment of an appropriate risk rating. Then the FRR refers to rating given to the facility the obligor is applying for.

The GCPPM insists on the importance of continuous gathering of information on the customer, market, industry and reporting to the Credit Committee and Management.
Among the warning signs that may draw the Bank's attention on the borrower, we can mention:
- Recurring casual overdrafts or line excesses that take a long time to clear.
- Frequent delays in repayment of principal or interest payments.
- Inability to communicate with customer and failure to disclose information.
- Major management changes especially in financial area people and key decision makers.
- Negative market trends, Government directives, Legal suits and/or bankruptcy threats by other creditors.
- Deterioration of economic environment.
- New competition in industry.

2. <u>Credit classification and provisioning</u>

There are four main objectives attributed to the Bank's credit classification system to:

1. Highlight those credits that represent an above-normal credit risk.
2. Evaluate the degree of risk involved.
3. Develop a strategy or action plan for the elimination of weakness and the ultimate collection of outstandings.
4. Assist the calculation and reserving of appropriate loan loss provisions.

Category	Loan classification system	Provision
Class I : *"Uncriticized"* *(Current)*	Credits that are fully current and the orderly payment of which is without doubt.	1%
Class IA : *Other Assets* *Especially* *Mentioned* *("OAEM")*	Credits with evidence of weakness in the borrower's financial condition or credit worthiness, or which are subject to an unrealistic repayment programme, or which are lacking adequate collateral, credit information or documentation. If sufficiently severe or advanced, these or other conditions would warrant a worse classification. Early attention, including substantive discussions with borrowers, is required to correct deficiencies	10%
Class II : *Substandard*	Credits for which the normal repayment of principal and interest may tee, or has been, jeopardized by reason of severely adverse trends or developments of a financial, managerial, economic, or political nature, or by important weaknesses in collateral. No loss is foreseen, but a protracted work out is a possibility. Prompt corrective action is required to strengthen the Bank's position as a lender, to reduce its exposure, and to ensure that adequate remedial measures are taken by the borrower.	25%
Class III : *Doubtful*	Credits, full repayment of which appears questionable on the basis of available information, and which therefore suggest a degree of eventual loss not yet determinable as to amount or timing. Vigorous action is required to avers or minimize losses. Non accrual of interest is required and previously accrued and unpaid interest must be reversed. The principal should be reversed or written off to the extent deemed necessary. Any such credits should be reported to the local Board of Directors and the ETI Board.	50%
Class IV : *Loss*	Credits that are regarded as uncollectible. Any amount so classified by account management, should be fully reserved, and previously accrued and unpaid interest must be reversed. A classification to IV does not mean that there is no potential for eventual recovery. Responsible units are expected to continue a vigorous collection effort until it is decided that no further repayment or recovery is possible. Any such credits must also be reported to the local Board of Directors as well as to the ETI Board.	100%

It is important to underline that some assets, though not worth classifying require special attention. These are put in a "watch list" category. The watch list is not a requirement but it is done in the aim to attract the bank's attention to them. There is no provision made on them.

Another aspect of the classification is that an asset can move from class I to IV without passing through classes IA, II or III. On the other hand, an asset classified III can become I within a short period. This is quite understandable because the overdue period of the loan is not the only criterion taken into account for loans classification. A company can move from a healthy situation to very bad one and vice versa.

3. Remedial management

Strategies to recover loans that are classified are made based on a case-by-case analysis. Actions are taken according to the severity of the classification. Nonetheless, the GCPPM gives some guidelines of objectives to achieve according to the classification:

Class IA:

- Reduction of total exposure.
- Improvement of security margin by incremental collateral.
- Review of the loan documents to ensure enforceability.

Class II:

- Prepayment of some of the obligations.
- Request for client to find alternative bankers.
- Legal action.

Class III:

- Legal action to enable the bank to exercise its rights under the security arrangements
- Appointment of a liquidator

Class IV:

- Legal action to enable the bank to exercise its rights under the security arrangements
- Appointment of a liquidator

CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATIONS

This chapter applies the framework of problem loans management developed, from the last chapter to some problem loans files. The idea is to compare the Bank's handling of problem loans with the criteria of the framework.

In this chapter, we will:

- Present how we sampled the population, defined the variables and collected data.
- Explain the methodology we followed to analyze and interpret data
- Present the outcome of data collection
- Analyze and interpret data

For matters of confidentiality, names of companies studied are not given. Only numbers are attributed to files to identify them.

I. Data collection

1. Sample selection

The population of the study was all problem loans files classified at January 31, 2005 and the unit of analysis a problem loan file. The size of the population was 24 and the sample size 50%. The stratified method was used for the following reasons:

- The population was incongruous because problem loans files fall into four categories.

- The sample was designed to reflect the structure of the population so that files from each class would be studied.

The structure of the sample was as follows:

Classification	Population size	Theoretical sample size	Practical sample size
Class IA	11	5,5	6
Class II	3	1,5	2
Class III	3	1,5	2
Class IV	7	3,5	4
Total	**24**	**12**	**14**

Finally, a practical sample of 14 problem loans files was used.

2. <u>Variables</u>

Before listing the variables studied, it is important to recall the being answered in this part. The question is: "What actions are taken when loans become problem loans?" The four variables focused on are:

- the financial situation and/or age of the overdue amount
- the classification
- the provision
- the remedial strategy

a. *The financial situation and/or overdue period*

The financial situation of a borrower is the main factor that justifies its classification in the Bank's classification system. It is more likely to help understanding the classification and then the provision to be made and remedial strategy to be adopted.

In the classification we built and considered the best, the main factor of classification is the overdue period. Nonetheless, the financial situation of the borrower is not meaningless.

Then, we collected information on both financial situation and overdue period to explain and justify the classification.

Information on financial situation of companies was in the form of text and figures. To avoid problems of interpretation and find standards of judgment (Hussey and Hussey, 1997), we decided to detcxtualize and rank the different financial situations on a Likert scale. The following ranks were kept:

1. Mitigated   2. Serious losses, critical   3. Poor   4. Distress

b. *The classification*

This variable is important because when a loan becomes a problem loan the first action is to classify in order to highlight and keep attention on it and separate it from "safe" loans. Moreover, the classification indicates the level of riskiness of the loan. As seen before, the Bank runs a five-tier classification system: I, IA, II, III and IV; I being the unclassified class.

For this reason, we will have four classifications: IA, II III and IV.

The Bank's classification system is analogous to that developed for this study and this is shown below:

Bank's classification	Our classification
I	A
IA	B
ll	C
III	D
IV	E

c. The provision

Once a loan is classified, provisions must be taken to cover the expected losses and the level of provision depends on the classification level and must comply with it. This reflects prudence from the accounting perspective and it is required by regulation.

d. The remedial strategy

By remedial strategy, we mean the actions taken by the Bank to follow-up the credit and make sure repayment will be made. Due to the complexity and the heterogeneity of the remedial strategies, this variable was not ranked this variable as for the financial situation. Nevertheless, we summarized strategies on a case-by-case basis.

3. Data collection method

Our data source was the Monthly Classified Loan Management Reports (MCLMR) from two departments that deal with large corporates and SMEs.

Information contained in the reports includes:

- Facilities and outstandings.
- Brief classification history.
- For new classifications, a brief relationship background.
- Provisions.
- Security or Support held, inclusive of estimated asset value.
- Summary of latest financials.
- Reasons for classification and action plan.

The study made is a longitudinal study and the aim was to observe the behavior of the different variables at three different periods. The periods chosen were: January 31, April 30 and August 31 of the year 2005.

Questionnaires were used for data collection (see format appendix 3).

II. Data analysis methodology[16]

As mentioned earlier, the bank's practices are to be compared with the standards distilled from the literature as constituting best practices in problem loans management. The methodology used will be explained here.

For each of the variables the analysis will focus on the similarities and dissimilarities of the bank's practices and the guidelines of the framework.

1. Classification

The classification of a loan captures its level of risk. Either in the Bank's classification or in ours, the classification is made as per the financial situation and/or overdue period of the loan. The classification on, at January 31st, April 30th and July 31st, is evaluated to determine whether the classification of the loan is in compliance with its financial situation and/or overdue period according to our criteria.

Our analysis and interpretations is based on two aspects of the observations:

1. The similarities between the treatment of the problem loans at the Bank and our criteria.

2. The dissimilarities between the treatment of problem loans and the practices we recommended.

2. Provisioning

For each classification a provision is required. Then, we will check and interpret whether the provision made by the Bank is compliant with the interval of provision suggested.

3. Remedial strategy

As for the two previous variables, we will compare the remedial strategies and action plans carried to those suggested by us.

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[16] For details concerning the files analyzed, please see appendix 4.

III. Outcome of data collection

Our data collection and analysis showed that globally the Bank's classification, provisioning and remedial strategies applied on files studied is similar to our suggestions. More explicitly, the following results came out according to the dependent variables (i.e. classification, provision and remedial strategy).

1. Classification

For facilities classified IA by the Bank, the corresponding classification in our system was B and 66% (4 out of 6) of the files were complying with this classification. The two others were classified IA by the Bank and C by us.

For the two files classified II by the Bank, 1 was classified C by us (the equivalent classification) and the other was classified D.

The facilities classified III and IV according to Bank's classification, the equivalent classification in our system was respectively D and E. 100% of the assets were classified similarly by both methods.

2. Provision

The provisioning system of the Bank was complying with ours for all statistical units of the sample except one. For this particular one, the fact is that the facility was fully secured by cash collateral. Then, neither our system nor the Bank's required a provisioning.

3. Remedial strategy

Only 3 of the 14 files studied were not proposed the same remedial strategy both by Bank and us. The other 11 files were similarly treated regarding the remedial strategy.

More specifically, for 5 of the 6 assets classified IA, the Bank had proposed strategy comparable with the prescriptions of the framework, which was to closely monitor and follow-up the credit. For all others, strategies were almost all the same as per the classification system. The actions taken varied from security enhancements to legal action, through facility restructuring to legal action.

Despite these variable-oriented results from data collection, other outcomes need to be highlighted:

- 4 of the 6 files in class IA were declassified before August 31 (being 66%). 50% of facilities classified II were also declassified before the last observation date. On the other hand, 50% (2 out of 4) in financial distress were written-off before last date of observation.
- We observed only one case of worsening of company's financial situation judged mitigated at January 31.
- Companies in critical financial situation did not significantly changed unlike the ones initially in poor situation, which moved to financial distress and those so far in distress who remain in that situation when they were not written off.

IV. <u>Data analysis and interpretation</u>

Overall strategies to remedy were similar in 78% of cases studied and dissimilar for the rest. There is no doubt that the similarities are signs of the same understanding and assessment of the situation by both the Bank and us.
The following must be underlined concerning the dissimilarities observed.

1. <u>Dissimilarities in classification</u>

In all cases of dissimilarities except one, our classification was more severe than that of the Bank. Several reasons can justify that fact:

- *Client relationship:* The Bank had a historical client relationship with the borrower that has not been taken in consideration in the data collection and decision-making.
  It is likely that if a client who has always been a good one is in difficulties, the Bank will treat him as if it had no previous relation with him.
- *Inside information:* Some information on borrowers not mentioned in the reports because of their sensitivity but useful to the decision-making may induce the Bank to make a classification inconsistent with that of the framework.
- *Lenient financial assessment:* Differences in classification particularly when the Bank's classification is less severe than ours could be due to lenient assessment of the financial situation of borrowers and can lead to losses.

2. **Dissimilarities in remedial strategies**

For the same reasons as for the classification, the Bank's remedial strategies may differ from those expected. Moreover, we noted that the Bank was hardly taking decisions to exit the business. Despite the worse situation of some borrowers classified IV by the Bank, it took difficult decision like liquidating collaterals and taking legal action. Most of the facilities of IV-classified borrowers were restructured several times before the Bank took legal actions. This delayed decisions the Bank could have taken earlier. The effect is losses through extra resources consumption and legal charges (file n°4-001).

CHAPTER FIVE: RECOMMENDATIONS AND CONCLUSION

Using a sample of problem loans files, we assessed the problem loans management practices of the Bank and compared them to what we set up as best practices in problem loans management. The overall outcome showed that in 78% of the cases studied, the practices of the Bank were complying with ours.

At first sight, this percentage is good. Although, we provided arguments to justify the discrepancies we also noted some weaknesses that if well managed can improve the existing problem loans management practices.

The present chapter is divided in four parts:

- *Pre-lending:* refers to measures that should be taken before granting a loan. They are related not only to the credit activity but also to the overall bank policies and incentives.

- *Credit monitoring* is about the effective follow up of the credit on the continuous basis from disbursement to full repayment of principal and interest.

- *Workout strategies:* will provide strategies to manage and recover problem loans.

- *Conclusion* will end the study.

I. Pre-lending recommendations

1. Industry risks

Caution should be taken to avoid two kinds of risk related to the industry:

1) Avoid great exposure to a specific industry and have at any time, a clear idea of its exposure to different industries so that if the industry collapses it can manage the trickle down effects.

2) Make sure the borrower is not going to invest the money in an industry in distress.

2. Collateral risks

The way a contract is made may weaken the Bank when the transaction with the borrower turns bad. In some files examined notice was made that the Bank was hardly trying to add personal properties of the owner of the company to collateral so that it could get its money

back. To prevent the Bank from such situations the loan agreement contracts must include strong clauses like:

- The increase of collateral in cases of weaknesses of the financial situation of the borrower
- The market value of collateral must fully cover the amount of the debt especially with companies with small number of shareholders.

3. Information system

The Bank must have an information system that works properly and efficiently to provide any information such as:

- Collateral pledged by a borrower is also pledged in one or many other transactions with other banks. This can lead to litigious situations.
- In case of cross default i.e. if the borrower fails to meet his obligations with another bank. This should normally involve the classification of the borrower at least on a watch list.

4. Size and ownership of the companies

All 4 companies classified IV by the Bank had small numbers of shareholders. In addition, the debts of 2 of them have been written of and the others were taken to court. Such small companies must be treated with carefulness because as noted they have a higher risk profile. Lending to such companies must not be done before the Bank has the assurance that the companies' clients are solvent. Facilities to those companies must mostly be granted to finance specific transactions and the proceeds must be domiciliated in the Bank's books.

5. Portfolio growth incentives

Generally, credit officers are awarded incentives based on the assets booked. They may not be careful enough to the transactions they recommend to the Bank. If relationship officers and other credit officers are awarded based on a "Quality-portfolio-oriented incentives" it will make the Bank have a safety growth of its credit portfolio.

6. Companies dealing with Governments

Governments often fail to meet their obligations timely. When lending to companies dealing with Governments the Bank must assume that the likelihood of untimely repayment is high, especially when the repayment of the facility is supposed to be done upon settlement of the transaction with the Government.

II. Credit monitoring

Maximum information should be obtained on the borrower's ability to generate adequate cash flow to service the debt. Sources of such information can be other banks, companies dealing with the borrower (suppliers and clients as well), newspapers.

Semi-annual financial statements should be required by the Bank to have a constant opinion on the borrower's creditworthiness.

Visits should be paid to clients to assure the Bank the most accurate information on them.

III. Work-out strategies

1. Effective teamwork

The collection team should include:
- An account officer: being the first to get in touch with the client, the account officer is the one supposed to have the maximum information on the borrower. In addition, even if a client is in financial distress today, he might be a good borrower tomorrow. For that reason, he needs to be treated with care.
- A remedial management officer: he is responsible for championing the recovery efforts. He is also in charge of restructuring, monitoring and generating appropriate reports.
- A legal department officer: his role is to assure that all decisions and measures taken in the collection effort are lawful.

2. Incentives

The recovery of a loan is sometimes tiresome and boring especially when it's lasting long. This may discourage the collection team and they may abandon sooner. A way to overcome

this problem may be to encourage by rewarding them with cash, facilities as per how much money they recover and how quickly.

3. Additional risks

Caution should be taken not to unnecessarily extend more 'good money' to an already stressed relationship with the hope of recovering the 'bad money'.

If the continuity of the borrower's activities is the only condition to recover the loan, the Bank may assist the company but only in acceptable limits of risk.

4. External debt collectors

We do not advise to carry the collection to external agencies. A 'bad borrower' today may be a 'good borrower' tomorrow and since theses agencies have no client relationship to protect, they are likely to act with coercion.

In the special case where the Bank is obliged to carry the collection effort to an external agency, care should be taken not to abandon the recovery effort to these agents. They should be given specific targets, monitored and require report to the Bank.

5. Enforcement of collateral

The significance of the Collateral as a secondary means of repayment should always be borne in mind during the recovery process. This should influence the bank's corporate disposition and efforts in managing security-related elements in credit structuring: value, type, quality, insurance, documentation deferral and perfection among others. Depending on the psychology of the local market, the actual process of liquidating collateral may have to be initiated to encourage, threaten or induce repayment.

IV. <u>Conclusion</u>

To conclude this study, we can say that the assessment of the whole problem loans management practices of Ecobank Ghana Limited showed that:
- the Bank's credit risk management processes are complying with the international standards
- the workout strategies for problem loans arc satisfactory

Nonetheless, we noted that strategies to sort out some problem loans often took long times.

The recommendations we made are mostly based on the credit risk management processes and authors agree that sound risk management processes can lower loan losses.

This shows the importance of having a clear credit policy and procedure manual that should be available and very well understood by any employee of the bank.

The Board of the bank should have an oversight of the risk management and it (the risk management) should be integrated in a day-to-day decision making.

The insistence on the role of the risk management system in problem loans management may discourage some banks in taking risks. But this should not.

As aforesaid in the introduction, risk is inherent to banking particularly lending activities.

The CEO of one Fortune 500 corporation, asked to explain his company's declining performance, fingered the "lack of a culture of risk taking".

The issue is not to avoid taking risks but to develop a series of controls and 'checkpoints' to evaluate accurately the level of risk to be taken and how bearable it is for the bank. Measurements of performance should no more be limited to traditional accounting measures but should integrate 'risk-adjusted' components.

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APPENDIX

Appendix 1: Loan loss provisioning in selected emerging markets

		Loan Classification System	Provisioning Requirements
Asia			
Hong Kong, China	Performing	Borrowers are current in meeting commitments and full repayment of interest and principal is not in doubt.	There are no requirements as to provisioning other than that individual banks have their own internal guidelines for maintaining adequate provisions. Interest must be accrued to a suspense account if loans are substandard and not fully secured or overdue by more than 6 months; interest accrual ceases altogether for substandard loans past due more than 12 months and for loans classified as doubtful or loss. Loans must be written off after they are deemed irrecoverable.
	Special mention	Borrowers are experiencing difficulties; ultimate loss is not expected but could occur.	
	Substandard	Borrowers displaying definable weakness; loan losses or rescheduling at concessional terms are possible.	
	Doubtful	Collection in full is improbable; loss of principal and/or interest is expected, taking account of collateral.	
	Loss	Uncollectible after exhausting all collection efforts, including realization of collateral.	
India	Nonperforming	Loans on which interest is overdue for at least six months.	None.
	Substandard	Loans that have been nonperforming for up to two years, term loans on which the principal has not been reduced for more than one year, and all rescheduled debts.	10 percent
	Doubtful	Loans that have been nonperforming for two to three years and term loans on which the principal has not been reduced for more than two years.	100 percent of unsecured assets; for secured assets, 20 percent if doubtful for less than one year; 30 percent if doubtful for one to three years; 50 percent if doubtful for more than three years.
	Loss	All other assets deemed irrecoverable, where the loss has been identified by internal or external auditors or by the Reserve Bank of India inspectors, but where the amount has not been written off.	100 percent. Interest accrual stops once loans are nonperforming. For loans with balances below Rs 25,000, banks must set aside reserves equal to at least 10 percent of the balance.
Indonesia	Current	Installment credit with no arrears, other credit in arrears less than 90 days, overdrafts less than 15 days.	0.5 percent.
	Substandard	Generally, loans with payments in arrears between three and six months	10 percent
	Doubtful	Nonperforming loans that can be rescued and the value of collateral exceeds 75 percent of the loan, or loans that cannot be rescued, but are fully collateralized.	50 percent. 100 percent.
	Loss	Doubtful loans that have not been serviced for 21 months; credit in process of bankruptcy liquidation.	Loans must be written off 21 months after litigation indicates the loan will not have to be repaid.
Korea	Current	Borrower's credit conditions (including collateral) are good and collectibility of interest and principal are certain.	0.5 percent.
	Special mention	Payments are past due for between three months and six months, but collection is certain.	1 percent.
	Substandard	Loans covered by collateral but borrower's credit conditions are deteriorating and payments are more than six months past due.	20 percent.
	Doubtful	Unsecured portion of the loans that are more than six months past due and losses are expected.	75 percent
	Estimated loss	Unrecoverable amounts due net of collateral.	100 percent Loans must be written off within six days of being declared unrecoverable; write-offs in excess of W800 million require Bank of Korea approval.

Appendix 1: *(continued)*

		Loan Classification System	Provisioning Requirements
Malaysia			For loans less than RM 1 million:
	Substandard	More than a normal risk of loss due to adverse factors; past due for between 6 and 12 months.	0 percent.
	Doubtful	Collection in full is improbable and there is a high risk of default; past due for between 12 and 24 months.	50 percent of net (of collateral) outstanding value.
	Bad	Uncollectible; past due for more than 24 months.	100 percent of net outstanding value.
			Loans must be written off when bankruptcy hearings have finished and/or partial or full repayment is unlikely.
			A general provision of at least 1 percent of total loans net of interest in suspense and specific provisions is also required.
Philippines	Unclassified	Borrower has the apparent ability to satisfy obligations in full; no loss in collection is anticipated.	0 percent of net (of collateral) exposure.
	Special mention	Potentially weak due, for example, to inadequate collateral, credit information, or documentation.	0 percent.
	Substandard	Loans that involve a substantial degree of risk of future loss.	25 percent.
	Doubtful	Loans on which collection or liquidation in full is highly improbable; substantial losses are probable.	50 percent.
	Loss	Uncollectible or worthless.	100 percent.
			Interest is not accrued on past-due loans, which are loans or other credit not paid at the prescribed maturity date or, in the case of installment credit, in arrears by more than a prescribed amount depending upon the frequency of installments.
Singapore	Special mention	Accounts with evidence of potential weakness in creditworthiness, such as untimely repayment.	A provision of 50 percent of the loan value for defaults of over a year; for defaults of 3 to 6 months provision is the difference between the loan amount and 80 percent of collateral; for 6 to 12 months, the difference between the loan amount and 70 percent of the collateral. In aggregate, 100 percent of substandard, doubtful, and bad loans must be provided for, with those graded doubtful to have at least 50 percent provision.
	Substandard	Normal repayment may be jeopardized by continuing adverse trend of severe financial weakness.	
	Doubtful	Repayment of outstanding debt appears questionable; expectation of loss.	
	Bad	Outstanding debt is uncollectible.	
			Loans must be written off in the year that they are recognized as a loss. The Monetary Authority of Singapore has established a minimum (tax exempt) general provision of 2 percent of outstanding loans (including accrued interest) net of specific provisions.
Taiwan Province of China		Nonperforming loans (on which interest is not accrued) are: 1. Short-term loans with principal payments three months past due. 2. Loans with interest payments (or installments) six months past due. 3. Loans to companies for which legal proceedings by the bank have commenced.	Only provisions (general and specific combined) up to 1 percent of loan balance are tax deductible. Specific provisions in excess of that amount are made on a quarterly basis. Interest is no longer accrued after 180 days. Loans must be written off after all legal proceedings have finished.
Thailand		Loans are nonperforming (substandard or doubtful) if they are 12 months past due but fully collateralized or secured, or if they are 6 months past due but not fully secured.	
	Substandard	Loan is in arrears, but there is sufficient security to ensure that full recovery of the debt will be possible.	15 percent (by end-June 1999; at least 7.5 percent by end-June 1998).
	Doubtful	Loan is in arrears, but there is insufficient collateral.	100 percent.
	Irrecoverable	Legal enforcement has been initiated and has been unsuccessful.	100 percent.

Europe			
Czech Republic	Watch	Accounts overdue by 30-90 days.	5 percent of net (after collateral) exposure.
	Substandard	Accounts overdue by 91-180 days.	20 percent of net exposure.
	Doubtful	Accounts overdue by 181-360 days.	50 percent of net exposure.
	Loss	Accounts have been overdue for more than a year, there is little likelihood of repayment, and assets are not adequately secured.	100 percent of net exposure.
		Restructured loans must be classified as substandard for six months after restructuring and then as watch for three years.	
Hungary	Performing	Assumption that interest or principal will not be more than 15 days overdue.	0 percent.
	To be monitored	No loss is assumed, but management is of the opinion that the exposure requires separate monitoring.	0-10 percent.
	Substandard	Risks are higher than average or some loss may be assumed at the time of classification.	11-30 percent
	Doubtful	A loss will be incurred but the size of the loss is uncertain or where payment is at least 90 days past due or payment delay becomes regular.	31-70 percent.
	Bad	The loss will exceed 70 percent or the company is in bankruptcy	71-100 percent.
			General reserves (out of net income) must amount to 1.25 percent of the balance sheet total plus 1 percent of guarantees.
Poland	Standard	No arrears or doubts about the borrower's financial strength; receivables guaranteed by the state.	None.
	Substandard	Loans in arrears by more than a month, or loans to a borrower with weakened financial standing.	20 percent
	Doubtful	Loans in arrears by more than three months, or loans to a borrower with deteriorating financial standing	50 percent
	Loss	Loans in arrears by more than six months or the subject of legal dispute, or loans to a borrower who is either in liquidation or whose location is unknown, or whose financial standing makes repayment impossible.	100 percent
			Approval for lower provisions may be given if the loans are adequately collateralized. General reserves may be set up without limit, although reserves equal to only the first 1 percent of impaired loans are tax deductible.
Turkey	Special follow-up	Loans to uncreditworthy borrowers (defined as borrower whose capital is insufficient to pay the debt when due, or borrower lacks the ability to pay the debt, or the borrower's working capital is insufficient to meet its operating needs).	Initial 15 percent provision. Increased to 50 percent by the end of the first year. 100 percent after two years.
	Administrative follow-up	Loans classified as overdue or one month in arrears.	15 percent provision is required after two months (i.e., when 90 days past due).
	Legal follow-up	Loans in arrears for three months.	25 percent provision is required after 6 months, rising to 50 percent after one year, 75 percent after 18 months, and 100 percent after two years. Banks must cease accruing interest on loans in legal follow-up.
		Loans to state entities (including state-owned enterprises) are not included in the classification system, and provisions are not required for these loans.	

Appendix 1: *(concluded)*

		Loan Classification System		Provisioning Requirements		
Latin America						
Argentina		*Consumer loans*	*Commercial loans*	*Liquid guarantee*	*Preferred guarantee*	*Without guarantee*
	Normal	Less than 31 days overdue.	No doubt exists.	1 percent.	1 percent.	1 percent.
	Potential risk	31–89 days overdue.	Performing, but sensitive to changes; or more than 90 days overdue.	1 percent.	3 percent.	5 percent.
	Problem	90–179 days overdue.	Problems meeting obligations; or 90–179 days overdue.	1 percent.	12 percent.	25 percent.
	High risk	180–365 days overdue or subject to judicial proceedings for default.	Highly unlikely to meet obligations; or more than 180 days overdue.	1 percent.	25 percent.	50 percent.
	Irrecoverable	More than 365 days overdue.	Obligations cannot be met; more than 365 days overdue.	1 percent.	50 percent.	100 percent.
	Irrecoverable for technical decision	Bankruptcy/liquidation insolvency.	Bankruptcy/liquidation insolvency.	100 percent.	100 percent.	100 percent.
Brazil		*Consumer loans*	*Commercial loans*	*Unsecured*	*Partially/fully secured*	*Export/import*
		0–29 days overdue.	0–29 days overdue.	0 percent.	0/0 percent.	0/100 percent.
		30–59 days overdue.	30–59 days overdue.	0 percent.	0/0 percent.	100/100 percent.
		60–180 days overdue.	60–180 days overdue.	100 percent.	50/20 percent.	100/100 percent.
		181–360 days overdue.	181–360 days overdue.	100 percent.	100/20 percent.	100/100 percent.
		More than 360 days overdue.	More than 360 days overdue.	100 percent.	100/100 percent.	100/100 percent.
Chile		*Consumer loans*	*Commercial loans*	*Allowance*		
	A	Current.	Probability of default: 0 percent.	0 percent.		
	B	1–29 days overdue.	Probability of default: less than 5 percent.	1 percent.		
	B	30–59 days overdue.	Probability of default: 5–40 percent.	20 percent.		
	C	60–119 days overdue.	Probability of default: 40–80 percent.	60 percent.		
	D	More than 120 days overdue.	Probability of default: 80–100 percent.	90 percent.		
Colombia		*Consumer loans*	*Commercial loans*	*Unsecured principal*	*Interest*	*Secured principal*
	A (Normal)	Current.	Current.	0 percent.	0 percent.	0 percent.
	B (Subnormal)	30–59 days overdue.	30–119 days overdue.	1 percent.	1 percent.	0 percent.
	C (Deficient)	60–89 days overdue.	120–179 days overdue.	20 percent.	100 percent.	0 percent.
	D (Doubtful)	90–179 days overdue.	180–359 days overdue.	50 percent.	100 percent.	0 percent.
	E (Unrecoverable)	180–360 days overdue.	360–719 days overdue.	100 percent.	100 percent.	0 percent.
	E (Unrecoverable)	More than 360 days overdue.	More than 720 days overdue.	100 percent.	100 percent.	100 percent.
Mexico		*Consumer loans*	*Commercial loans*	*Allowance*		
	A	Minimal risk.	Minimal risk.	0 percent.		
	B	Low risk.	Low risk.	1 percent.		
	C	Moderate risk.	Moderate risk.	20 percent.		
	D	High risk.	High risk.	60 percent.		
	E	Noncollectible.	Noncollectible.	100 percent.		

Loan loss reserves should be at least equal to the greater of (1) reserves calculated according to the above classification; (2) 4 percent of total loans; or (3) 45 percent of past-due loans. The entire amount of an amortizing loan (including past-due interest)

is considered past due if any payment is 90 days overdue (180 days for mortgages). Nonamortizing bullet loans are past due if more than 30 days overdue. Credit cards are past due when two minimum payments have been missed. Loans restructured into CDIs are transferred to trusts (consolidated into the bank's financial statements) and attract a 15 percent loan loss reserve.

		Consumer loans	Commercial loans	Unsecured consumer	Unsecured commercial
Peru					
	A (Normal)	Current.	Current with no doubts.	0 percent.	0 percent.
	B (Potential problem)	10-29 days overdue.	Demonstrated difficulties.	5 (on total balance) percent.	1 (on total balance) percent.
	C (Substandard)	30-59 days overdue.	Serious weaknesses.	30 percent.	25 percent.
	D (Doubtful)	60-120 days overdue.	Making payments, but less than contracted.	60 percent.	50 percent.
	E (Loss)	More than 120 days overdue.	Unrecoverable.	100 percent.	100 percent.

		Consumer loans	Commercial loans	Allowance
Venezuela				
	A (Normal)	Fully performing.	Fully performing.	0 percent.
	B (Potential risk)	1-3 monthly payments overdue.	Performing, but showing signs of potential future problems (e.g., deterioration of financial condition, inadequate documentation).	5 percent.
	C (Real risk)	4-6 monthly payments overdue.	Experiencing delays in interest and/or principal payments with estimated losses.	10 percent.
	D (High risk)	7-12 monthly payments overdue.	Interest and/or principal payments three months or more past due and where legal recovery proceedings have been initiated.	50 percent.
	E (Irrecoverable)	More than 12 monthly payments overdue.	Interest and/or principal payments are 12 months past due or where legal proceedings indicate very scarce possibility of recovery.	100 percent

Once a loan is 30 days past due it is placed on nonaccrual status, and a reserve equal to 100 percent of accrued interest must be created immediately. Loans must be written off after 36 months. Provisioning requirements do not apply to credits guaranteed by the Venezuelan public sector.

Consumer Loans
Provisioning based on the amount of principal overdue for A-D loans. For E loans, the reserve must take into account the entire outstanding balance.

Sources: IBCA Ltd.; ING Barings Securities; and J.P. Morgan.

Annex 2: The 25 core principles of the Basel Committee on Banking Supervision

Principle 1: An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorisation of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.

Principle 2: The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.

Principle 3: The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organisation's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organisation is a foreign bank, the prior consent of its home country supervisor should be obtained.

Principle 4: Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.

Principle 5: Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.

Principle 6: Banking supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basel Capital Accord.

Principle 7: An essential part of any supervisory system is the independent evaluation of a bank's policies, practices and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.

Principle 8: Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices and procedures for evaluating the quality of assets and the adequacy of loan loss provisions and reserves.

Principle 9: Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentrations within the portfolio and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.

Principle 10: In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.

Principle 11: Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.

Principle 12: Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor and adequately control market risks; supervisors should have powers to impose specific limits and /or a specific capital charge on market risk exposures, if warranted.

Principle 13: Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor and control all other material risks and, where appropriate, to hold capital against these risks.

Principle 14: Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.

Principle 15: Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict "know-your-customer" rules that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.

Principle 16: An effective banking supervisory system should consist of some form of both on-site and off-site supervision.

Principle 17: Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.

Principle 18: Banking supervisors must have a means of collecting, reviewing and analysing prudential reports and statistical returns from banks on a solo and consolidated basis.

Principle 19: Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.

Principle 20: An essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis.

Principle 21: Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.

Principle 22: Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.

Principle 23: Banking supervisors must practise global consolidated supervision over their internationally active banking organisations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organisations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.

Principle 24: A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.

Principle 25: Banking supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.

Appendix 3: Sample questionnaire format

FILE N°:

JANUARY		
Financial situation / Overdue period:		
	Actual Management	**Suggested Management**
Classification		
Provision		
Remedial strategy		

APRIL		
Financial situation / Overdue period:		
	Actual Management	**Suggested Management**
Classification		
Provision		
Remedial strategy		

AUGUST		
Financial situation / Overdue period:		
	Actual Management	**Suggested Management**
Classification		
Provision		
Remedial strategy		

REMARKS:

Appendix 4: Sample Questionnaires

FILE N°: 1-001

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JANUARY		
Financial situation / Overdue period: Mitigated		
	Actual Management	**Suggested Management**
Classification	IA	B
Provision	10%	10% - 15%
Remedial strategy	Monitoring	Close monitoring, follow-up

APRIL		
Financial situation / Overdue period:		
	Actual Management	**Suggested Management**
Classification		
Provision		
Remedial strategy		

AUGUST		
Financial situation / Overdue period:		
	Actual Management	**Suggested Management**
Classification		
Provision		
Remedial strategy		

REMARKS: At February 28, 2005 the company has been declassified.

Appendix 4: Sample Questionnaires

FILE N°: 1-002

JANUARY		
Financial situation / Overdue period: Critical		
	Actual Management	**Suggested Management**
Classification	IA	C
Provision	-	-
Remedial strategy	Continue relationship and exposure up to collateral value	Short Term repayment schedule of outstandings

APRIL		
Financial situation / Overdue period: Critical		
	Actual Management	**Suggested Management**
Classification	IA	C
Provision	-	-
Remedial strategy	Continue relationship and exposure up to collateral value	Repayment schedule Use of collateral

AUGUST		
Financial situation / Overdue period: Critical		
	Actual Management	**Suggested Management**
Classification	IA	C
Provision	-	-
Remedial strategy	Sustain company's working capital	Use of collateral to repay outstandings

REMARKS: No reserves were taken by the Bank as all outstandings were secured by cash collateral.

Appendix 4: Sample Questionnaires

FILE N°: 1- 003

JANUARY		
Financial situation / Overdue period: Serious losses, critical		
	Actual Management	**Suggested Management**
Classification	IA	C
Provision	10%	25%-30%
Remedial strategy	Loan restructuring program	Fully secure the loan with more collateral Restructure the loan

APRIL		
Financial situation / Overdue period: Mitigated		
	Actual Management	**Suggested Management**
Classification	IA	B
Provision	10%	10% - 15%
Remedial strategy	Close monitoring	Close monitoring, follow-up

AUGUST		
Financial situation / Overdue period: Mitigated		
	Actual Management	**Suggested Management**
Classification		
Provision		
Remedial strategy		

REMARKS: After May 31, 2005 the company has been declassified.

Appendix 4: Sample Questionnaires

FILE N°: 1-004

JANUARY		
Financial situation / Overdue period: Mitigated		
	Actual Management	**Suggested Management**
Classification	IA	B
Provision	10%	10% - 15%
Remedial strategy	Monitoring Sustain company's needs	Close monitoring, follow-up

APRIL		
Financial situation / Overdue period:		
	Actual Management	**Suggested Management**
Classification		
Provision		
Remedial strategy		

AUGUST		
Financial situation / Overdue period:		
	Actual Management	**Suggested Management**
Classification		
Provision		
Remedial strategy		

REMARKS: At March 30th, the company has been declassified.

Appendix 4: Sample Questionnaires

FILE N°: 1-005

JANUARY		
Financial situation / Overdue period: Mitigated		
	Actual Management	**Suggested Management**
Classification	IA	B
Provision	10%	10% - 15%
Remedial strategy	Monitoring	Close monitoring Follow-up

APRIL		
Financial situation / Overdue period:		
	Actual Management	**Suggested Management**
Classification		
Provision		
Remedial strategy		

AUGUST		
Financial situation / Overdue period:		
	Actual Management	**Suggested Management**
Classification		
Provision		
Remedial strategy		

REMARKS: At February 28th, the company has been declassified.

FILE N°: 1-006

JANUARY		
Financial Situation / Overdue Period: Mitigated		
	Actual Management	**Suggested Management**
Classification	IA	B
Provision	10%	10% - 15%
Remedial strategy	Close monitoring	Close monitoring, follow-up

APRIL		
Financial situation / Overdue period: Mitigated		
	Actual Management	**Suggested Management**
Classification	IA	B
Provision	10%	10% - 15%
Remedial strategy	Keep monitoring	Close monitoring, follow-up

AUGUST		
Financial situation / Overdue period: Critical		
	Actual Management	**Suggested Management**
Classification	IA	C
Provision	10%	10% - 15%
Remedial strategy	Keep monitoring	Close monitoring, follow-up

Appendix 4: Sample Questionnaires

FILE N°: 2-001

JANUARY		
Financial Situation / Overdue Period: Critical / STL overdue for 7 months		
	Actual Management	**Suggested Management**
Classification	II	D
Provision	25%	50% - 75%
Remedial strategy	Close monitoring Commencement of legal action and sale of collateral	Sell collateral Take legal action Exit the business

APRIL		
Financial situation / Overdue period: Still critical		
	Actual Management	**Suggested Management**
Classification	III	D
Provision	50%	50% - 75%
Remedial strategy	Legal action if outstanding not paid-off by September 30, 2005.	Sell collateral Take legal action Exit the business

AUGUST		
Financial situation / Overdue period:		
	Actual Management	**Suggested Management**
Classification		
Provision		
Remedial strategy		

REMARKS:

FILE N°: 2-002

JANUARY		
Financial situation / Overdue period: Critical		
	Actual Management	**Suggested Management**
Classification	II	C
Provision	50%	25% - 30%
Remedial strategy	Wait for IPO outcome	Restructure the facility Repayment schedule

APRIL		
Financial Situation / Overdue Period: Critical		
	Actual Management	**Suggested Management**
Classification	IV	D
Provision	100%	50% - 75%
Remedial strategy	Wait for IPO outcome to pay off the facility Legal action if the company's position is not settled by September 30, 2005.	Sale of collateral

AUGUST		
Financial situation / Overdue period: Poor		
	Actual Management	**Suggested Management**
Classification	IV	D
Provision	100%	50% - 75%
Remedial strategy	Declassify the company	Declassify the company after settlement

REMARKS: As result of an agreement, total outstandings of the company were supposed to be settled by its brokers and written off.

Appendix 4: Sample Questionnaires

FILE N°: 3-001

JANUARY		
Financial situation / Overdue period: Poor / 3 months overdue after restructuring program		
	Actual Management	**Suggested Management**
Classification	III	D
Provision	50%	50% - 75%
Remedial strategy	Close monitoring of company's activities	Fully secure the loan with additional collateral and closely monitor company's activities and proceeds

APRIL		
Financial situation / Overdue period: Poor		
	Actual Management	**Suggested Management**
Classification	IV	D
Provision	100%	50% - 75%
Remedial strategy	New restructuring plan	Sell collateral and commence legal action

AUGUST		
Financial situation / Overdue period: Distress		
	Actual Management	**Suggested Management**
Classification	IV	E
Provision	100%	100%
Remedial strategy	Liquidation if the company if not able to perform under the new restructuring plan	Sell collateral, take legal action and exit the business

FILE N°: 3-002

JANUARY		
Financial situation / Overdue period: Distress		
	Actual Management	**Suggested Management**
Classification	III	D
Provision	50%	50% - 75%
Remedial strategy	Close monitoring of company's operations	Take legal action Sell collateral

APRIL		
Financial situation / Overdue period: Distress		
	Actual Management	**Suggested Management**
Classification	III	E
Provision	50%	50% - 75%
Remedial strategy	Close monitoring of company's operations	Take legal action Sell collateral

AUGUST		
Financial situation / Overdue period: Distress		
	Actual Management	**Suggested Management**
Classification	III	E
Provision	50%	100%
Remedial strategy	Close monitoring of company's operations Proposal of a restructuring plan	Take legal action and sell collateral if company does not agree on the restructuring plan of 50% down payment

Appendix 4: Sample Questionnaires

FILE N°: 4-001

JANUARY		
Financial situation / Overdue period: Facility overdue for 19 months		
	Actual Management	**Suggested Management**
Classification	IV	E
Provision	100%	100%
Remedial strategy	Writing off	Legal action Exit the business

APRIL		
Financial situation / Overdue period: Distress		
	Actual Management	**Suggested Management**
Classification	IV	E
Provision	100%	100%
Remedial strategy	N/A	Legal action Exit the business

AUGUST		
Financial situation / Overdue period:		
	Actual Management	**Suggested Management**
Classification		
Provision		
Remedial strategy		

REMARKS: Account has been written off by July 31, 2005.

Appendix 4: Sample Questionnaires

FILE N°: 4-002

JANUARY		
Financial situation / Overdue period: Distress		
	Actual Management	**Suggested Management**
Classification	IV	E
Provision	100%	100%
Remedial strategy	Writing off and legal action	Take legal action and exit the business

APRIL		
Financial situation / Overdue period: Distress		
	Actual Management	**Suggested Management**
Classification	IV	E
Provision	100%	100%
Remedial strategy	Writing off and legal action	Take legal action and exit the business

AUGUST		
Financial situation / Overdue period:		
	Actual Management	**Suggested Management**
Classification		
Provision		
Remedial strategy		

REMARKS: Account has been written off by July 31, 2005.

Appendix 4: Sample Questionnaires

FILE N°: 4-003

JANUARY		
Financial situation / Overdue period: Distress / facility overdue for more than 9 months after restructuring.		
	Actual Management	**Suggested Management**
Classification	IV	E
Provision	100%	100%
Remedial strategy	Close monitoring and legal action	Legal action

APRIL		
Financial situation / Overdue period: Distress		
	Actual Management	**Suggested Management**
Classification	IV	E
Provision	100%	100%
Remedial strategy	Continue legal action to recover outstandings	Legal action

AUGUST		
Financial situation / Overdue period: Distress		
	Actual Management	**Suggested Management**
Classification	IV	E
Provision	100%	100%
Remedial strategy	Continue legal action to recover outstandings	Legal action

Appendix 4: Sample Questionnaires

FILE N°: 4-004

JANUARY		
Financial situation / Overdue period: Distress		
	Actual Management	**Suggested Management**
Classification	IV	E
Provision	100%	100%
Remedial strategy	Legal action for the sale of company's trucks Application of proceeds to offset the company's indebtness	Legal action to obtain the sale of company's assets to liquidate the debt

APRIL		
Financial situation / Overdue period: Distress		
	Actual Management	**Suggested Management**
Classification	IV	E
Provision	100%	100%
Remedial strategy	After the sale of the 3 trucks, write off the balance	Legal action for the sale of company's assets and exit the business

AUGUST		
Financial situation / Overdue period: Distress		
	Actual Management	**Suggested Management**
Classification	IV	E
Provision	100%	100%
Remedial strategy	After the sale of the 3 trucks, court to attach owner's personal properties	Legal action for the sale of company's assets and exit the business