

Tetyana Bolgar

D.Sc. (Economics), Associate Professor,

Poltava National Technical University

named after Yuriy Kondratyuk

24 Pershotravnevyy Ave., Poltava, 36000, Ukraine

e-mail: t.bolgar@mail.ru

Compliance-collection as modern direction in non-performing loans reimbursement

Abstract. The important current issue for banking establishments of Ukraine is loan debt, search of efficient ways for its paying back, improvement of methods and development of measures to reduce loan debt. Nowadays, the qualitative index of banks in banking system of Ukraine is essentially reduced and the part of non-performing loans increases simultaneously. Such dependence causes anxiety either at the level of a separate bank or at the level of banking system. The National Bank of Ukraine regulates and monitors the banking activity on the base of legislative and normative documents, which are constantly reviewed and supplemented. However, as the given investigation and the volume of loan debt show that 25.8% is of the total volume of the allowed credit dated by 01/09/2016, we can thoroughly talk about urgent necessity to search new ways to manage banking activity in non-performing loans reimbursement.

The statistics of non-performing loans shows that inside-banking collection does not give enough optimistic results of its activity in non-performing loans reimbursement at present time. With ever-increasing frequency, external collectors are used offering their services in credit reimbursement. Exactly at this stage, the questions of legislative base of the process of debt collection, analysis of methods and approaches used by external collectors intensely arise.

The direction of activity of collection and compliance has been investigated in the article. The definition of “compliance-collection” has been made on the base of available experiments. The necessity to implement new scientific and methodical approaches into activity of bank establishments and financial institutions in non-performing loans reimbursement has been proved.

Key words: bank, bank activity, collection, compliance, borrower, non-performing

loans, financial institutions.

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Болгар Т. М.

доктор економічних наук, доцент, кафедра фінансів і банківської справи,
Полтавський національний технічний університет імені Юрія Кондратюка,
Полтава, Україна

**Комплаєнс-колекшен як сучасний напрям діяльності з повернення проблемної
кредитної заборгованості**

Анотація. У статті проаналізовано стан проблемної кредитної заборгованості у банках України, що з 2013 року стрімко зростає. Розглянуто організацію та досліджено методи, котрі використовуються банками та фінансовими установами при стягненні проблемної заборгованості. На основі вивчення понять «комплаєнс» та «колекшен» надано визначення «комплаєнс-колекшен», що дало можливість запропонувати нове розуміння напряму діяльності у поверненні проблемної кредитної заборгованості.

Ключові слова: банк, банківська діяльність, колекшен, комплаєнс, позичальник, проблемна кредитна заборгованість, фінансові установи

Болгар Т. Н.

доктор экономических наук, доцент, кафедра финансов и банковского дела,
Полтавский национальный технический университет имени Юрия Кондратюка,
Полтава, Украина

**Комплаєнс-колекшен как современное направление деятельности по
возврату проблемной кредитной задолженности**

Аннотация. В статье проанализировано состояние проблемной кредитной задолженности в банках Украины, которая с 2013 года стремительно растет. Рассмотрена организация и исследованы методы, которые используются банками и финансовыми учреждениями при взыскании проблемной задолженности. На основе изучения понятий «комплаєнс» и «колекшен» дано определение «комплаєнс-колекшен», что дало возможность предложить новое понимание направления

деятельности при возврате проблемной кредитной задолженности.

Ключевые слова: банк, банковская деятельность, коллекшен, комплайенс, заемщик, проблемная кредитная задолженность, финансовые учреждения.

1. Problem statement. Present-day situation concerning the level of non-performing loans in banking system of Ukraine can be suggested as critical one. The rapid increase of the index of non-performing loans in total volume of allowed credits shows insufficient activity of organizing and systematic measures used in non-performing loans reimbursement. In particular, they are the following: the absence of effective and organized system of risk-management banks which would be able to resist challenges of dynamic changeable situations in all spheres of national economy – political, economic and legislative areas of a state; imperfection of management activity of banks and financial establishments, the usage of new methods and measures in non-performing loans reimbursement that contradicting moral and ethical standards; legislative and rule-making problems.

To solve the stated above problems, some theoretical and practical investigations should be done. This testifies the actuality of getting active and on-time results which will give the possibility to define the reasons and solve the range of problems to decrease the volume of non-performing loans.

Within recent years, the quantity of banks in banking system of Ukraine sharply decreases caused by either subjective or objective reasons. Banks stop their activity and non-performing loans remain, and their part increases every year.

Nowadays, non-performing loans reimbursement made by efforts of bank establishments does not give the expected results, the reason of which is in absence of effective and harmonious system of risk-management of banks, imperfect legislature, attitude of debtors to borrowed resources. These and other reasons supported development of collection business in Ukraine and increase of demand and service concerning non-performing loans reimbursement. Until nowadays, collector's activity in Ukraine is not legislatively regulated, that is why, in such period, the question of responsibility and control of the process of non-performing loans reimbursement arises.

The concept of “compliance-collection” as the direction of activity in non-

performing loans reimbursement within legal and legislative frames of a state has been introduced by the author in the given investigation.

2. Analysis of recent research and publications. The stated above problem in non-performing loans reimbursement in banking system of Ukraine becomes particularly topical. Increased interest of famous leading scholars is reasonable. The reasons of non-performing loans have been investigated by the following scholars as: R. Brand (1994) [1], V. Volokhov [2], O. Dzyublyuk [3], V. Kovalenko [4], I. Lyuty, P. Moroz [5], J. Soros (1999) [6], A. Fyodorov (http://www.reglament.net/bank/legal/2011_2/get_article.htm?id=1306) [7] and others.

Nevertheless, the issues of implementation and development of modern approaches to non-performing loans reimbursement are need to be investigated and developed. It is necessary to gain the experience in bank establishments' activity of world highly developed countries. The questions of collector activity, improvement and implementation of compliance-control into banks activity have been defined in the works of H. Bortnikov (http://www.iaa.ru/inner_auditor/publication/foreign_mass_media_articles/bortnikov/) [8], A. Havrikov [9], N. Dyeyeva [10], L. Kalinichenko [11] and other scholars.

3. The purpose of the article is to search and develop new scientific and methodical approaches to non-performing loans reimbursement by the way of “compliance-collection” implementation.

4. The main results of the study. The most active periods of increase of the index of non-performing loans in total volume of loans provided in banking system of Ukraine became 2008–2010 and 2013–2016 (Figure 1).

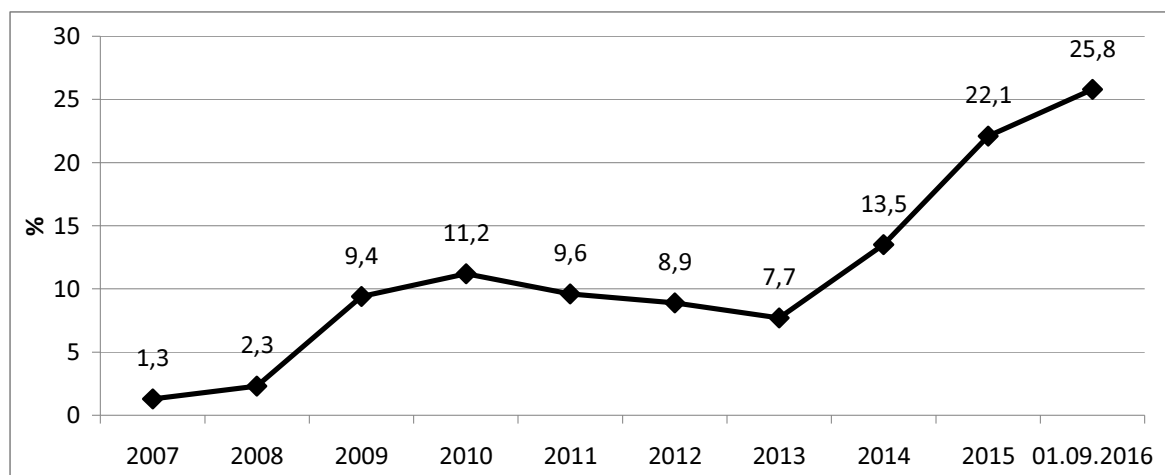


Figure 1. The part of overdue loan debt in total volume of loans provided during

2008–01/09/2016.*

*done on the base of [12]

The part of loan debt in total volume of loans provided dated by 01/09/2016 is 25.8 %, which is bigger in three times than the index dated by 2013. Such situation with non-performing loans is observed on the base of the fact that Tsince the beginning of 2016 during 8 months the quantity of banks in banking system of Ukraine decreased in 16 times and it involves 100 banks dated by 01/09/2016. Peculiar attention should be paid to the fact that the quantity of banks decreases but the level of non-performing loans increases.

The ways of non-performing loans reimbursement are different, they are the next: efforts of banks subdivisions which are structural subdivisions of a bank-creditor and companies paying back distressed debts according to credit agreements but they are not structural subdivisions of a bank-creditor, they are collection companies or collection firms.

“Collection” means “encashment”, collection of cash cost. Now the meaning of this term “collection” is changed, it is not simple collection of cash cost but collection of debts.

Collection companies are organizations providing services in debt recovery. That is to say, collection is the main type of activity of collection organizations, the service provided by them.

Collection business appeared in the USA in the 1960-s and in the beginning of the 1980-s was spread in Europe, in Ukraine, the first collection company appeared in the autumn of 2006 and today, the quantity of collection companies is 200. This phenomenon has a long history and its own corporate culture and philosophy abroad, in Ukraine, collection companies provide their services for bank establishments in non-performing loans reimbursement according to commission contract, assignment contract, factoring agreement and according to regulatory acts about collection activity, and they are the following:

- Constitution of Ukraine;
- Civil Code of Ukraine;
- the Law of Ukraine “On Banks and Banking Activity”;
- the Law of Ukraine “On Information”;
- the Law of Ukraine “On Financial Services and State Regulation of Financial

Services Markets”;

- the Law of Ukraine “On Personal Data Security”.

Providing acquirement of some volume of non-performing loans by a collection company, this company can itself choose the strategy of collection and use the instruments of collection. This fact solves the external debtor’s problems because he has no obligations to represent the name of banking establishment and to be correspondent for its reputation during the processes of non-performing loans reimbursement acting on the base of commission charge having investigated into the property of some volume of non-performing loans.

Increase of non-performing loans reimbursement caused the possibility for collection companies to redeem the portfolio of non-performing loans with high discount (up to 90%). The price of redeem can be even less than 1% of the rest of debt according to credit agreement in case loan is unrecoverable. In other words, discount exceeds 99% in such case [13].

To achieve the strategic aim – non-performing loans reimbursement with maximal profit, collection companies use actively legal practice but the problem is that collectors act strictly enough according to debtors of inside-banking collection. External collectors do not take into account the reputation of their company using the measures of influence to the borrowers violating the norms of legislature and moral standards, management of companies pays attention to borrower’s behavior and do not take into consideration aggressive behavior of collectors violating law and human freedom. We consider this practice to be intolerable which causes negative results for clients, their psychical and emotional state. The question concerning necessity to implement active state control according to similar behavior of collection companies is urgent. It will give the possibility to control a firm collecting debts; require their complying with the laws, removing drawbacks and implementation of the ways of collection within the laws of a state.

We can make the following conclusions that the main function of collectors is debt collecting. This function can be defined as service providing by a collector for corresponding borrowers where a collector is a mediator between a creditor and a debtor. Buying the right of demand in creditors to debtors, what allows to correct obligations of the parties. Introduction of modifications into obligations is one of the most problematic

aspects because collectors increase the amount of indebtedness using penalties and fines. The agreement arranged by a creditor is the reason of performing functions by a collection agency.

Approved requirements in the Article 1082 CC of Ukraine about loan reimbursement to a new creditor (factor) are corresponding to common requirements of CC of Ukraine about the change of a creditor in obligation (chapter 47) [14].

Thus, collectors' activity, which arrange agreements about deviation of the right of demand, can be suggested as the activity of financial establishment on the market of financial services considering as factoring operation which obliges collection agency as the subject of initial financial monitoring to observe the law in the sphere of protecting of illegal income legalization. Although, the activity of financial establishments (collection agencies) collecting debts from natural persons is subject to licensing, but, the mechanism of realization of the indicated requirement on the level under the law is absent. That is why, there are no reasons to make organizations responsible for realizing the indicated financial operations without corresponding permission (license). Therefore, the chain of mutual relations "factor – client – borrower" becomes "collector – creditor – borrower".

Bank, which highly appreciates its reputation as a reliable and clear financial establishment, should work correspondingly to better international standards and create corporate culture of intolerance to corruption and tries to observe the law, its letter and its spirit. Still, the trust of clients, investors and companions is based on the confidence in that all services are provided with observance of the base of professional ethics and high standards of quality.

Proceeding from the stated above, compliance is suggested as correspondence of the activity of an establishment with the law, standards and ethical business conduct what is an important factor of strengthening of trust to financial institutions and the indicator of their legal maturity.

Investigation of non-performing loans reimbursement gives the possibility to affirm that banking establishments and collection companies solve the same issues but under different conditions as for an establishment as for clients.

Compliance is a control, as an effective instrument of minimization of compliance-risks, coming confidently on key positions in management of modern organizations,

besides, not only financial institutions but also companies of a real economic sector. Within the increased pressure from regulators and many criminal investigations, the value of compliance-function in business increases every year. Nowadays, on the national market, there is a clear understanding of compliance as an inseparable part of the system of control of corporate management and the benefit from its implementation is considerably bigger than those risks occurring without it. At present time, practical results of creating, development and work of compliance-functions at national companies can be analyzed; the efficiency of conducted meetings can be evaluated; the influence of following the principles of compliance on the indications of their constant development can be analyzed.

In the opinion of Basel Committee, compliance of financial establishments is an independent function which reveals, evaluates, gives corresponding advices, prepares reports about the risks of compliance defined as a risk of legal and regulatory sanctions, financing of damages, the loss of reputation that can influence a bank or financial institution as a result of violating the law, regulation, code of behavior and high practical standards of the activity. Laws and rules are derived from different sources including the basic law, normative acts and standards, code of ethics and internal codes of behavior [14].

5. Conclusions. Thus, having investigated the activity of banks and collection agencies in non-performing loans reimbursement, we suggest to introduce the next concepts: *compliance-collection as the direction of professional activity with debtors in non-performing loans reimbursement which realizes the function of observing the laws, codes, norms, rules, regulation of activity and is a part of corporate culture of credit/financial establishment.*

To achieve efficiency in the work of non-performing loans reimbursement, the body, which will regulate the activity on legal level and manage financial establishments (banking, financial and credit establishments) and act in non-performing loans reimbursement (internal banking and external collection), should be created. We consider such body to be created at National Bank of Ukraine and it should be under the control of the Head of NBU. Obligations, authorities, operations and functions of oversight body should be directed on the activity in non-performing loans reimbursement. Such measures are considered to give the possibility to shorten the volume of debt loan and guarantee the

security, ethical attitude to debtors with non-performing loans, and, what is the most important, these measures will be under the control and conducted in accordance with the requirements of the national law.

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