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Azerbaijan Republic**

**Problematic of Bad Debts
Portfolio in Azeri
Banks: Ways to Overcome and
Conceivable Solutions**

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Abstract

It can be noticeable that the Azerbaijani economy in the first decade of the 21st century has a compelling growth in the banking sector.

Commercial banks perform a huge role in this improvement. The banks' capital rose promptly and became a significant factor in Azerbaijani economic growth. Nonetheless, always a negative side follows the conclusion of any growth. Broaden operation forces to debt rate boost in most commercial banks. Particularly bad loans rate increased swiftly. Bad debts became a severe issue for the Azerbaijani economy.

After oil prices falling down, there were rough results on Azerbaijan and its banks. The state, which depends on hydrocarbons for more than half of its revenue, had no alternative to devalue its currency in 2015. A quarter of banks' assets have gone worse, and smaller lenders and banks have out of business. Due to this problem, controlling the bad loan rate is not easy work for all banks. There is no model of resolution for all banks. In accordance with particular characteristic of every bank, distinguishing resolutions to control bad debt rate are provided.

The goal of this study is assessing bad debt management policies and exploring Azeri banks as a case study. Policies of credit risk management policies are examined to contribute to the exploration as well. Because it has huge part in controlling bad debt rate in Azeri economy.

This thesis also tries to build a picture of the lending procedure and norm of Azeri banks. Moreover, the Central Bank of Azerbaijan's regulations and policies are also examined to help to the research.

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Introduction

1.1 *Background of Study*

Commercial Banks have been widely recognized for their rare role as tool of growth and development in any economy. Commercial Banks are main players of every countries` economy, particularly in financial sector. Moreover, the banking sector has been known for its intermediation function in supplying financial aid (credit) needed in the economy. This role is usually accomplished in many ways, for instance, granting of loans and priority to customers, which form the major part of bank lending. Banks are simply protector of the money they lend; therefore, interest must be paid to depositors and dividends to the investors. Credit management must be considered as a necessary part of lending and as such in its absence, good loans may be turning to bad debts. Unluckily, some of these debts usually do not operate and in the long run result in bad loans that influence banks earnings on such debts. Hence, nowadays too many financial institutions especially commercial banks are constantly being faced with bad loan problem which is having hardships dealing with that problem.

Bad debt is debt that is not collectible and bad debt issue means money owed by people or institutions which are likely to unrecovered. Bad debt issue is covering over several years thereby posing hazard to their profit margins, sustainability and working capital. Bad loan problem is causing confusion in financial sector. Because non-recovery of loans in financial contracts is widely spreading information asymmetry among borrowers and lenders in financial markets regarding their creditworthiness.

During two recent years, the Azerbaijani Government has been taking several provisions to doing some amendments in the country's banking system. However, there is a lack of any understandable strategy to deal with bad debts issue, whereas credit risk management techniques employed by commercial banks are not so effective.

1.2 *Statement of the problem*

Bad debt are commonly is one of the most general reasoning that causing banks to fail their activities and facing with bankruptcy. In modern economy, banking, financial institutions such as commercial banks have experienced big amount of losses is because of non-repayment of loans. Debt portfolio is usually the largest asset and the main source of revenues for commercial banks. Indeed banks generated extremely large income from their debt portfolio but accessible literature demonstrates that such kind of big portions of banks loans typically went bad. As a result, these loans affect the performance of these institutions in financial side. The increasing volume of such kind of loans pose serious menace to financial stability and at the end — threat to overall economic stability.

In Azerbaijan, banks' bad debt problems began when Azerbaijani economy started weakened. At the beginning of 2015, the country's national currency, the Azeri manat, depreciated by 35%, and the main reason of this devaluation has been a serious and sudden drop in oil prices. Accordingly, the charge of servicing the bank's external debt increased by 20 percent, since banks' borrowings were in foreign currency but as a credit to people in local currency - manats. Further depreciations and defaults on loans caused in a growth in the rate of

nonperforming loans, which in just 3 months reached nearly 80 percent of the bank's total assets. If banks don't take the measures to minimize the bad debts, that issue can lead to the downfall of banks which have large balances of these non-performing loans. In Azerbaijan, the banking industry has an significant role in the growth of the economy. Afterwards big amount of bad debts could affect banks in the performance of developing role of economy. In that reason, after unexpected high-ranked increasing of bad loans, 14 banks were closed in Azerbaijan.

In view of the above, it is necessary to detect the range of the impact of bad debts on banks performance and determine the reasons why and ways to overcome of bad loans of banks in Azerbaijan.

Bad debts affect all players of financial system such as employees, stakeholders, shareholders at large, but not only commercial banks which are major lenders of debts. Negative inducements on bank owners is becoming as a reason lending at very high interest rates to the borrowers than before. That's why most risky segments of the credit market can be blamed for bad debt problem.

For that reason, finding ways to overcome and solutions for bad and doubtful debts is one of the major challenges in commercial bank lending and therefore deserves research attention.

1.3 *Objectives of study*

According to the thesis theme initially, it is important to define some objectives of study in order to investigate systematically the problem. The study itself has a common objective of the process which is defining the cause of bad loan problem and finding several ways to overcome that problem smoothly in Azeri banks. Among other things, the study has the following specific objectives:

- What is problems of bad debt and controlling of bad debt rate in Azeri banks;
- To investigate the causes of bad debts in Azerbaijan Commercial Banks ;
- What ways and policies are applying for solving bad debt problem;
- To make positive recommendations on how to possibly profound solutions.

1.4 Research Questions

The study will embrace answers to the following questions:

- What kinds of impact of bad debt problem have on Azeri commercial banks which leading on country`s economy;
- What kind of measures are applied to cope with bad debt problem by a commercial bank?

1.5 Significance of the Study

Given the basic part that banks play in the economy, it is essential to recognize the issues influencing the exercises of these organizations. Credit portfolios make up the larger part of banks' benefits in Azerbaijan. These advantages create expansive premium pay for banks, which decides the money related execution of banks. Consequently, it can be inferred that a solid credit portfolio directly affects banks' budgetary execution. In any case, some of these advances are non-performing and negatively affect the banks' activities.

As indicated by the Fitch Ratings non-performing credits following two debasement (NPLs; 90 days late) surged to 21% of gross advances at end-2016 (end-2015: 12%) and we anticipate that banks' high presentation will outside cash advances (48% of aggregate advances at end-2016) to make more weight in 2017 in Azerbaijan. These non-performing loans can influence the banks' capacity to assume their part in the improvement of the economy.

1.6 *Limitation of the Study*

The fundamental task of the study is to research the bad debt issue in Azeri banks and discovering routes for taking care of this issue. The main limitation of this exploration is because of the commercial banks' information secure and mystery. It is difficult to get the unpublished information if you are not being a representative of banks in Azerbaijan. Inside the information gathered from the commercial banks' yearly report and the meetings with the staff individuals from the case banks, this proposal will not give an absolutely precision picture about the Azeri banks' financials. Be that as it may, this postulation will center around the arrangements and approaches utilized for bad debt issue.

The other restriction is because of the constrained measurements. Because of the political reasons, there are contrasts in numerous administration reports and the data is normally not precise. In this study, will be utilized the statistics that are closest to foreign reports.

2 Literature Review

2.1 Preamble

This chapter highlights on a relevant literature review on bad debts and other key aspects of the topic under this study. Before examining the problems of a portfolio of bad debts, this chapter will examine what bad loans are and how they arise and are controlled. Such areas as the description of the good loans, bad debts, the classification of loans and provisioning, the impact of problem loans on the activity of banks and the possible factors that lead to the emergence of problem loans. Thus, the chapter represents the conceptual and theoretical basis of the research.

2.2 The definitions and concept of bad debt portfolio

2.2.1 Definitions

Financial Asset

Assets is a resource owned by people, and containing some economic values. A financial asset is an asset that allows future benefits in the form of a requirement for cash (Pamela Peterson Drake, Frank J. Fabozzi, 2010). Options, bonds, stocks are examples of a financial asset. There are lenders who has a financial asset and gain benefits. In addition, there are debtors who will use the benefits of someone's financial assets and agree to pay for it. Accordingly, financial assets can be determined in the relationship between creditors and debtors.

As indicated by the ordinarily refer to definition from the International Financial Reporting Standards (IFRS), financial assets, include cash, equity instruments of another equity (a share certificate, for example), a contractual right to receive a financial asset from another entity (receivables), a contractual right to exchange

financial assets or liabilities with another entity under favorable conditions or a contract that will settle in an entity's own equity instruments.

Additionally, stocks and receivables, the above definition contains bonds, deposits, financial derivatives, and equity stakes. Huge numbers of financial assets do not have a set monetary value until the point when they converted into cash, particularly in the case of stocks; their values start to fluctuate as with other sorts of assets, for example, real estate or commodities.

Banks

Banks are the intermediaries, facilitating transactions in the capital market. Accordingly, banks will account for creating more transactions that are reliable in the capital market. Banks will accomplish two main functions, including funding from lenders and creditors, and lending the funds to debtors. (Pamela Peterson Drake, Frank J. Fabozzi, 2010)

Retail banking is one of the most familiar type of banking system. Retail banking system provides money services to families and individuals. Another kind of bank is online banks. This kind of banks operate over the internet. There are some examples of online banks that only operates online, such as ING and HSBC. However, nowadays too many banks also offer online services. For most commercial banks, savings and loans target mortgages. There are also have credit unions that only serve employees of companies or schools and provide personalized service. Commercial banks focus on businesses. Most retail banks also offer commercial banking services. Community banks are smaller than commercial banks. They concentrate on the local market. They provide more personalized service and build relationships with their customers.

Performing Loans

The main functions of banks are financing and lending. In other words, the funds will be invested or credited as loans. Credits are represented by a criterion, the ability to perform. Performing loans are loans that are timely paid principals and interest to banks. One of the main criteria for managing an effective bank is the ratio of performing loans.

According to the IMF, a performing loan is any loan in which: interest and principal payments are less than 90 days overdue; less than 90 days' worth of interest has been refinanced, capitalized, or delayed by agreement; and continued payment is anticipated. All conditions must be present for a loan to be performing. However, the specific definition is dependent upon the loan's particular terms. (Farlex Financial Dictionary. © 2012 Farlex, Inc. All Rights Reserved)

Legally, a credit or lending institution is a promise between two parties that one party agrees to give some money to the debtor and the said amount to the creditor to a lump sum or repayment of the installments for a certain period of time. The agreement may include the payment of additional rent charges for the funds paid to the debtor during the period that the debtor is in possession of the debt. Additional payments made in the form of transaction fees, commission fees, interest payments, and other charges are usually paid in addition to the main amount. In fact, these additional payments made in accordance with the loan contract represent lender or creditor income. Thus, a loan can be fulfilled if both the principal amount and the payments of interest charges are updated upon agreement between the creditor and the borrower.

Classifications of loans show that current loans are those for which the borrower is the last for payments of both interest and principal. It also shows that an overdraft will be

considered current or performing, if the account was a normal activity without signs of hardcore debt consolidation. The foregoing shows that loans that are relevant in terms of repayment of principal and interest are described as production facilities. These types of loans represent a quality portfolio of assets for banks, taking into account interest income received from such assets.

Bad loans

The term - bad loans is used interchangeably with ineffective and impaired loans. These types of loans are considered as problem loans. Thus, these descriptions are used instead of each other during the study.

Bad debt is one of the types of loans that default or probability of default (Investopedia.com). As in other areas of business, the capital market also contains various types of risks with a certain level. At the international level, people list different types of risks in the credit market, in which the credit risk is most noticeable. Credit is a credit and money relationship in which debtors pay principal and interest obligations during the crediting period. Credit risk is the risk of a situation where the debtor can not pay the principal or interest, or both.

If the bank has too many bad loans on its balance sheet, its profitability will suffer, because it will no longer earn enough money from its credit business. In addition, he will have to postpone the money as an insurance network in case he needs to write off the entire loan amount at any time. In addition, when it is necessary to write off the entire loan amount within a certain time, it will be necessary to allocate money as an insurance network.

As a rule, credits that are distinguished both on principal and on interest for a long time, contrary to the conditions contained in the loan agreement, are considered uncompleted loans. This is due to the fact that, following the description of the above loans, it follows that any credit facility that is not updated in terms of payment of both principal debt and interest, unlike the terms of the loan agreement, is untrue.

Bad debt provision

Bad debt provision is a mechanism over expected losses of non-performing loans. Practically appliance showed that the high ratio of bad loans requires the larger amounts of efficient provision. (Hasan and Wall, 2004)

Making provisions and maintaining the accounts correctly is important to understand the reasons. The Generally Accepted Accounting Principles (GAAP), widely demonstrate conservatism of matching revenues with expenses always needed and following the concept is essential. Conservatism provides us with a basis for creating reserves bad and doubtful debts. When loans do not become expense at once, they are often called doubtful loans. This provision helps corporations and banks to create a pillow from their bad debt expenses and future losses.

Making arrangements includes extra sections in the diary. Consequently, it is important to comprehend the process and implement it accurately as any mistake may prompt contrasts to be balance sheet, which is required additionally time and endeavors to be corrected. The accountant then, needs to follow the process systematically and balance the statements accordingly.

The calculation of provision also requires the use of the utmost care; the importance should be controlled and monitored by the financial department of any bank. The created judgment must not be very small or very large. The amount of the provision is

appropriated from the incomes of the business, it is important that the provision does not surpass to an extent, might be as a drain on the assets. Also, it must not be small to the point that the bad loan costs really acquired surpass the provision. In such circumstances, there are misfortunes to the business in spite of the provision. From these choices, the measure of provision is as imperative as making the provision itself. In Azerbaijan, the main factor considered when providing loans, is the ability of the borrower to pay the loan back. Nonetheless, in order to mitigate the risk of default, banks provide reliable credit protection. Although advances are made on the basis of the borrower's ability to repay an advance, and not on the basis of collateral of sufficient assets to cover the advance in the event of a default, it is highly desirable that all advances made to customers and employees are well secured. This means that in the event of a default, the bank must be the collateral used to provide a means to mitigate the consequences of the loss of principal and interest.

2.2.2 Reasons for emergence of bad debts in the banking sector.

There is a risk of lending to borrowers. This kind of risk occurs because the promised payment may not happen. Credit risk is characterized as potential losses emerging from the failure of credit clients to pay back what is paid fully and on its time. Bank lending includes a bank that provides a loan in exchange for a promise of interest and principal repayment in the future.

The current literature on lending points to the role of the lender in providing good credit solutions because of minimize credit risk. The lender should endeavor to assess the degree of risk and try to reduce the uncertainty that will emerge in the prospect of possible repayment. Therefore, the lender must collect all relevant data, and then apply his skills to make judgments.

Although there may be pressure from customers and elsewhere that may affect the creditor's decision, the lender must strive for an objective solution.

In view of these credit risks that can lead to problem loans, banks have some procedures and requirements for credit requests contained in their credit policy reports to direct credit officers in processing loans to clients.

The bank's policy shall address the bank's treatment of problem loans. In consideration of its operational characteristics, each bank shall define problem loans and determine criteria for classification of loans as problem loans. Status of a loan should be considered deteriorated if any of the following applies:

- financial information required by the bank was not provided on time;
- interest and principal payments are delinquent;
- the borrower's actual cash flow deviates from the projections and business-plan presented;
- the borrower's financial position has deteriorated;
- a request has been made to extend the term for principal and interest repayment;
- lawsuits have been filed against the borrower;
- the borrower refuses to meet with the bank;
- the Centralized Credit Registry has reported a deterioration of the bank's creditworthiness;
- any other information has been obtained that may adversely affect the borrower's creditworthiness. For control purposes, each loan and borrower shall be addressed individually.

The bank's policy shall, among others, include the following control measures:

- measures taken to ensure that the borrower gets access to additional funds and provides supplementary collateral;
- measures taken in collaboration with the borrower in order to find ways to strengthen the borrower's financial capacities and creditworthiness (engaging advisory services, reduction of operating costs and/or increase of revenues, development of an asset disposal program, reorganization of the enterprise, development of a loan restructuring program, revision of loan terms, etc.);

- transfer of the borrower's loan-related obligations to another individual or legal entity;
- foreclosure on the collateral in order to recover the underlying loan in accordance with the existing laws.

When a bank's problem loans, especially non-performing loans reach a certain amount or threshold ratio to the loan portfolio, the bank should limit its lending operations and take appropriate sanitation measures.

Risk can occur in a bank, in a company, in a business activity, or in a normal person's life. We can face with risk in everywhere. Risk is "the likelihood of something going wrong in the future". The risk to the business is defined as the "probability of financial loss" (Finance and Banking Dictionary, 2008, 386). As in other sectors, the banking sector is also facing banking risk. According to the Basel Accords issued by the Basel Committee on Banking Supervision, there are three main types of risk in the banking sector. These are credit risk, market risk and operational risks . Crouhy, Galai and Mark in “The Essentials of Risk Management” (2006) in Figure 1 present another classification of banking risks.



FIGURE 1.Types of banking risk (Croughey, Galai & Mark 2006, 26)

Banks must deal with eight major risks, as in Figure 1. These are credit risk, strategic risk, market risk, operational risk, business risk, liquidity risk, legal risk, and reputation risk. We can say that banking is extremely risky. Since the main activity of the bank is lending, credit risk is the greatest risk.

Banks must withstand credit risk, which is one of the biggest risks among types of banking risks. This banking risk is the nearest to bad debts. When debtors of the bank cannot repay their debts and debts' interest to the bank, the credit risk arises in the bank's balance sheet. Credit risk management is one of the main decisions that banks use to deter credit risk. The problem of bad loan is the major reason of credit risk. Bad debt is debtor debt that is unlikely to be paid. Bad debt rate is the percentage of bad debts of the entire banking system or the bank. The reasons for creating of problem loans in the banking sector presented here do not constitute a range of issues.

The explanations behind rise of issue advances in the keeping money area displayed here do not constitute a limited arrangement of issues.

The analysis of the importance of individual factors that would define their impact on engendering bad debts in the banking sector was not carried out. This was mainly based on the premise that the importance of factors differs among individual banks.

Origins of bad debts in the banking sector outlined above reflect the author's opinions, which draw on experience gathered during restructuring a portfolio of problem loans carried out in one of the major Azeri banks.

Domestic regulations of banks should include the settlement of bad loans by the bank. Based on the characteristics of its business, the bank should define the concept of bad loans and criteria for classifying credit as problematic.

The following are the reasons for the deterioration of the loan's status can be evaluated:

- failure to provide timely financial information requested by the bank;
- non-payment of interest on the loan and principal amount;

- discrepancy with the forecast and business plan presented in the borrower's cash flows;
- deterioration of the borrower's financial position;
- an application for the extension of the maturity of the principal amount and interest on the loan;
- removal of lawsuits against the borrower;
- the borrower's refusal to meet with the bank;
- Obtain information on the debtor's solvency deterioration from the Centralized Credit Registry;
- obtaining any other information that may have a negative impact on the borrower's solvency.

In some cases, SPV is used to take bad debts. Some banks or investors create an organization that is called an object of special purpose. A special purpose entity (SPE), also known as a special vehicle, "is a legally distinct legal entity with a limited service life set up to carry out a narrowly defined predefined activity for a" sponsoring "company" (Dharan 2002; Hargraves and Benston 2002). This legally significant organization can take the form of a corporation, limited liability company, partnership, joint venture, or trust. A narrowly defined predefined activity may be, for example, a large building project or the collection of receivables.

SPE is not a "real company" in the sense that no one works for SPE, all significant decisions are made in advance and do not have a physical location. It simply exists on paper. However, SPE is a completely independent object. This independence is a key feature of the SPE, as will be explained in the next section.

SPE appeared in the late 1970s. Consequently, SPEs have been around for quite some time, but they were in the spotlight only after the collapse of Enron. Enron used SPE to influence its financial statements. Thanks to SPE, Enron was able to hide losses and be less risky. But in the financial crisis of 2008, SPE also played a role.

Numerous financial institutions have invested in mortgage-backed securities, which are SPE.

In general practice, SPV is aimed at having borrowing from financiers and having the shares of the target company. The purpose of this work is to ensure that the debt is secured by the dividend income earned from the target company. In this way, the sponsor companies take as much risk as the capital they place on the SPV, and if the target company cannot get the credit for the loan, the sponsors lose their capital and the financiers stay with the target company shares.

SPVs have only the dividend income they receive from the target company and make the debt service with this dividend. Therefore, there is no continuous cash flows. As well as the fact that the maximum dividend amount is limited to 90.9% of the distributable profit of the target company and the SPV financing allowance cannot be deducted from the tax base of the target company, the two companies are merged within a short period of time. In this way, the debt in the SPV is carried over to the target company and both the debt and dividend payments are paid by the cash flow of the target company and the tax shield is used due to the financing transfer.

In Azerbaijan, although the creation of SPV is common for cross-border transactions. In internal transactions, the financed assets are held directly by the borrower. As a rule, stock security is insufficient and does not protect assets from disposals; therefore, security is usually taken for both stocks and assets.

2.3 Implication of Bad Loans for Banking Institutions

Credits are of great interest to banks that have made a significant contribution to the financial performance of the banks. However, when loans become worse, there are some negative effects on the financial condition of the banks. This is due to the fact that in accordance with the rules of the banks, they have provided sufficient reserves and fees to affect the bank's effective debt negatively. According to Bloem and Gorter

(2001), the biggest impact is on financial institutions, such as commercial banks and mortgage lending institutions, which tend to have large loan portfolios, although problems with the following loans may affect all sectors. At the same time, the large debts portfolio will also affect the credibility of banks. Bad loans can lead to bankruptcy and liquidity problems on the part of depositors and foreign investors.

The possible effect of bad loans is on the income of shareholders. Dividend payments are based on the banks' net profit. Thus, since bad loans negatively affect the profitability of banks, this can affect the amount of dividends payable to shareholders. As indicated in some foreign literature, bad debts can overcome the banking crisis and, ultimately, solve the problem of the collapse of banks with huge non-performing loans.

Demirgüç-Kunt et al (1989), cited in Berger and De Young (1997), indicate that banks are not likely to have huge shares of bad loans to failure and that asset quality is a statistically significant predictor of insolvency.

In the banking sector of Azerbaijan, the World Bank helps to cope with the problem of bad debt. To this end, the Azerbaijan Financial Market Supervision Authority (FMSB) and the World Bank will jointly understand another part of the financial sector modernization project. This project will consist of three areas: the protection of consumer rights, in particular, the formation of an effective regulatory framework for the financial sector, enhancing the stability of the banking sector and protecting consumer rights.

The first part of this program was completed in June 2016. According to the Financial Sector Development Program, the Swiss State Secretariat for Economic Affairs (SECO) has allocated a grant of \$ 4 million. USA for its implementation in 2012. It is also expected that SECO will provide \$ 3 million as part of the technical assistance for the second part of the project. The purpose of the second project is the modernization of the financial sector in Azerbaijan. Initially, it is planned to allocate 2.2 million dollars for this project. USA. Subsequently, SECO will designate \$

400,000 by November 30, 2018. Next year, an additional \$ 400,000 will be allocated by November 30, 2019. Finally, these three tranches will be fully drawn in accordance with the proper goal by August 2021.

Chairman of the FMSB Rufat Aslanli said that the second stage of this project will cover issues such as assistance to troubled banks, bad debts and others.

2.4 Loan Processing in Banks

The lending guidelines, as official instructions is created by the bank used in the main activity of the bank, lending. Typically, lending guidelines are essential tools that will contribute the bank's employees when working with credit applications.

The lending guidelines has many specific method that can be applied to different types of lending, such as mortgages, auto financing, credit loans, mortgages, etc. It can be said that lending recommendations are a combination of many credit policies for multiple types of lending crediting. For example, the policy of mortgage lending will be a list, which will indicate how mortgage loans are organized, assessed, approved, controlled and collected.

Since lending process is the most risky mission of the bank, the guidance on lending is clearly not easy. Each task in the lending manual consists of many conditions and should be checked by a multitude of people in the bank, from employees to managers. This is a process that takes time and requires careful study if the bank wants to eliminate credit risk.

Among the criteria outlined above, creditworthiness testing or valuation are one of the decisive stages of credit processing procedures. This is due to the fact that at this stage the information on financial stability and solvency of the client is analyzed.

Kay Associate Limited (2005) has identified five methods of credit verification, known as the five Cs-systems used in assessing a client's loan application. First, the

nature of the client is evaluated. This decides the ability of the client to pay the loan and may include a past loan record the credit rating of the firm and the customers and suppliers' reputation. Second, the client's ability is critically assessed, which is described as its ability to pay in terms of cash flow projections. Also, the capital or reasonableness of a borrower's financial position by the size of own capital is estimated. In addition, business's industry and economic conditions are evaluated. This is important, because such conditions can affect the client's ability to repay. The last C is a collateral. This is called a secondary source of repayment. This is taken into account when evaluating the client's request.

2.5 Monitoring and Control

Many lenders pay little attention to this area, but if it is accordingly implemented, the emergence of bad debts can be significantly reduced. Identified internal records, visits and interviews, verified accounts and management accounts as part of what helps in the control process and monitoring.

Monitoring can reduce the emergence of problem loans with the following four main objectives:

- Ensure that the loan is used for a promised goal.
- Distinguish early cautioning signals about any issue related to customer business operations that can affect the operation of the facility.
- Ensure compliance with credit conditions.
- This allows the lender to discuss the prospects and issue of the borrower's business.

At the bank level, credit analysis, credit policy, credit strategies and credit recommendations are the three main methods used in managing credit risk.

According to four main methods, a bank may have too many practical solutions for controlling credit risk and bad debt.

2.6 Reduction of bad loans

Bad loans can be limited by ensuring that loans are made only for repayment, and which probably will not become insolvent. Credit analysis of potential borrowers should be conducted in order to assess credit risk with the borrower and make a loan decision. Loan payments must be monitored and whenever there is a need to take default actions for customers. Therefore, banks should avoid providing loans to risky customers, monitor loan repayments and review their debts when customers are in a difficult situation (Kay Associates Limited, 2005).

The study is aimed at finding out whether non-compliance with these procedures and requirements in the field of lending can lead to problem loans in Azerbaijani banking institutions. He also seeks to identify measures that can be taken to minimize credit problems.

In this chapter, the main attention was paid to the main issues related to the topic of research, which were disclosed in the above literature. The following section details the methods and procedures used in the study and the underlying basis for adopting such research methods. It also provides a contextual profile of the bank's operating activities.

2.7 Advantages of bad debt in banking sector

The bank prefers not to abandon bad debts because of the debt portfolio is basic assets and the future as a source of income. Nevertheless, toxic loans, or loans that are difficult to collect at a reasonable or unrecorded level, are very poorly reflected in the financial statements of a bank and can direct resources from more

productive activities. Banks use deductions, sometimes called "amounts", to remove debts from their debts and reduce general tax liabilities.

The banks do not think that they will collect all the loans they make. For this reason, generally accepted accounting principles or GAAP require lenders to hold reserves against future bad loans. This is otherwise known as an allowance for bad debts.

For example, a company that makes \$ 100,000 in credit could cause a 5% or \$ 5,000 debt to be paid. After credits are made, they are immediately charged as a \$ 5,000 charge, since the bank does not wait until a real default is established. The remaining \$ 95,000 is recorded as a net asset in the balance sheet.

If more borrowers are assumed than expected, the bank will write receivables and receive additional costs. If the aforementioned lending authority actually has credit defaults of \$ 8,000, the entire amount is written and paid as an additional \$ 3,000.

As a result, when a non-performing loan is deleted, the tax lender receives a tax reduction from the loan value. Only the banks do not get a cut, they are also allowed to follow the debts and earn income from them. Another common option is that banks sell bad debts to third-party collection agencies.

2.8 International Experiences with Bad Debt problem

In Turkey, dealing with bad debt problem according to the Reuters, the news agency that reported on the economy, reported on April 2, 2008, "Akbank has reported that it has sold 248 million TL of the following loan portfolio to Venture Asset Management for 42 million TL. According to the statement made by the bank to the ISE, the whole of the sales price was reflected as income in the current period statements.

On March 31, Reuters published a report that YapiKredi Bank sold 532 million YTL of its overdue receivables portfolio to the Lehman Brothers Asset Management for YTL 60.5 million as a result of the tender.

In other countries, the "bad debt portfolio" sales that banks have often made have also started in Turkey those times.

Nowadays, the banks are giving credit to a lot of people because they go to consumer loans. Since many customers do not pay their loan or interest on time, a large number of credits of YTL 5,000- YTL 15,000 each are transferred to the "Doubtful Receivables Account". The bank must apply to the court for every loan transaction (file) that is not paid normally, to file a lawsuit, and to follow suit. But it is a problem for the banks to follow the small amount and the large number of receipt files.

For this reason, the banks put the receipt files in the "Bad Debt Account" as a package and sell them. Private companies operating under the name of "Asset Management" are buying these receivables at low prices.

The gains of the banks in these transactions, to get rid of the legal pursuit. As soon as possible, to collect a small amount of money they will receive. The earnings of Asset Management companies that buy receivables are how much money they can collect from the wholesale receivables package.

The encounters of the fast-track Central European (CE) countries, i.e., the Hungary, Poland and Czech Republic, with bankruptcy and bad debts give a rundown of more don'ts than do's. Of these three nations, the Czech Republic had a money related structure most taking after that of Azerbaijan with a generally high proportion of bank loans to GDP and shares of the overall industry of the enormous four banks of around 70% for loans and 80% for deposits. Besides, toward the start of the banking reform in 1990 in then Czechoslovakia, the greater part of the working capital of SOEs was funded by low-interest, short-term, rotating bank credit alluded to as TOZ loans. Konsolidacni Banka (KnB), a centralized hospital bank, was made for rebuilding

these loans on commercial terms. All TOZ advances were exchanged alongside a practically identical amount of enterprise deposits from alternate banks.

In any case, the SOE customers stayed with their parent banks that provided banking services and new credits. In a few phases, other loans classified as bad were exchanged from the biggest Czech banks to KnB for work out and the government recapitalized the parent banks.

Though considered fitting at the time, the Czech solution neglected to insure the quality of the local banking system. Neither the making of a separate hospital bank for credit obligations reached out on non-market terms nor a few rounds of cleaning up the banks' balance sheets made the enormous four Czech banks solid financial pillars.

What happened? Anything went wrong? Simply put, the foundations for a strong market-banking sector were not created. First, large banks have not achieved independence from the government as a state, with the majority or almost all of them remaining after these banks participated in the privatization of the voucher. Secondly, the problem of stimulation (flow) were not resolved, because banks not only retained their customers, but also became even more related to some of them as a result of the privatization of vouchers. When privatizing process, banks through their investment funds have acquired ownership interests in some of their customers, so that the potential arose for the conflict of interests between the banks as fair the holder and the bank as the holder of the debt obligation. When the crisis in mini-currency came, Czech firms caused discomfort and the banks' balance sheets suffered. It is interesting that the protectionist policy of the Czech government allowed domestic banks to maintain high spreads and, therefore, receive a reasonable profit. Even in this environment in which banks can self-pay, the problem with bad loans has not been resolved, because soft lending methods have been continued. Large Czech banks now need another round of significant recapitalization before they can be sold to foreign investors. Estimates now show that the total cost of restructuring banks in the Czech

Republic can be around 30% of GDP, which makes Czech cleaning the highest cost of the restructuring program in any transition economy to date.

In contrast, Hungary pursued a policy of privatizing state-owned banks by rapidly selling controlling stakes to strategic foreign investors. Such sales required recapitalization of banks to make a combination of current net worth and franchise attractive for a foreign investor. Two large and a few small recapitalizations of its national banks earned Hungary a dubious difference, as the country that most does not pay attention to moral hazard. The first major recapitalization was insufficient, either because the instruments used were not sufficiently liquid or financially attractive, but because the recapitalized banks still served bad clients. The second major recapitalization, using market-type instruments, was ultimately successful, as it was closely related to the privatization of independent, foreign owners. This joint strategy of recapitalization and privatization has left Hungary the strongest banking sector in all transition economies.

Hungarian experience points to the importance of achieving independent governance from both the state and unwanted customers. More important than inherited bad loans for promising bank operations, bad clients are inherited. The Hungarian bank, most exposed to unprofitable state-owned enterprises, was Magyar Hitel Bank (MHB). Prior to the search for a strategic foreign investor, but after recapitalization, MHB's loan portfolio was divided into good and bad assets. Bad loans along with the deposits of these customers were separated from the good part of the MHB, and a department was created to work with these clients in an attempt to recover some of the bad loans. Only a good bank was privatized; This transaction attracted a strategic foreign investor, who subsequently increased the bank's capital.

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The Polish experience testifies to the inexpediency of creating banks responsible for the restructuring of enterprises. The World Bank supported a restructuring program for banking enterprises based on the notion that a large bank lender has sufficient information about his clients either to facilitate restructuring or to take decisions on the liquidation of large state-owned enterprises. Financial restructuring dominated bankruptcy as the preferred option (Gray and Holle, 1996). The main instrument used to restructure loans was a set of debt obligations; this option was chosen disproportionately by weak banks. Thus, weak banks that do not have the experience of restructuring large companies were in the hands of their weak clients. In addition, a

new bank loan was granted to sick enterprises in about a third of the cases examined by Gray and Holle (1996). In one study by a Polish bank, Bonin and Leven (2000) found that the new loan granted to the three major military industrial customers within the program exceeded the total recapitalization of banks and left the bank more, and no less vulnerable to these customers after a financial restructuring. As in the Czech Republic, the Polish program has strengthened, rather than severed, the link between banks and their unwanted customers. Consequently, the Polish program provided a breathing space for weak state enterprises to postpone painful restructuring, while emphasizing the importance of banks depriving themselves of their unviable clients.

3. BAD DEBT PROBLEMS IN AZERBAIJAN

3.1 Analysis of bad debt portfolio in Azeri Banks

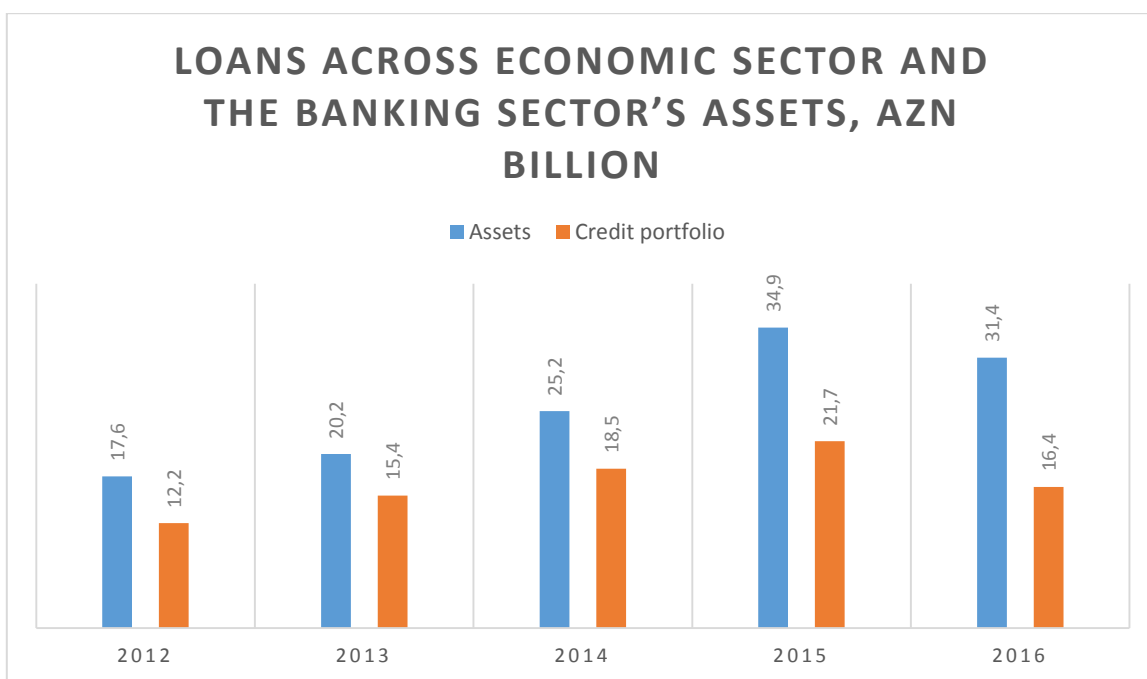
As we already know, in Azerbaijan, banking system has an essential role in country's economic system. In order to research bad debt problem in Azeri banks, we have to search the period after the last devaluation, those who were indebted to the banks and non-bank credit institutions in the currency, mainly loans in dollars, fell into a desperate situation. Some borrowers are returning to banks to solve the problem, and they try to settle their debts to other banks through new loans from other banks. In that way, amount of bad debts are increasing. According to economist-scientist, Gubad Ibadoglu, says that re-lending by banks to those who have bad debt or non-creditors serves a temporary solution to the problem and does not change the outcome.

In spite of the effective measures taken by government agencies in recent years, as well as the practical efforts of economic entities, the growth rate of debts continues to exceed the GDP. In the near future, businesses and organizations are expected to increase the amount of production and sales of goods (works and services), and the debts arising from settlements are expected to grow, in other words, the "debt swamp" is expected to deepen.

In 2016, there were 2 state banks operating in the country and the number of banks with foreign capital was 15. In most of the foreign capital banks (9 banks), less than 50% of the foreign equity capital was formed. Overall, 569 branches, 131 branches and 214 branches of non-bank credit organizations functioned in the reporting year. Assets of the banking sector in the reporting year amounted to 31.4 bn. manat. Amount of loans to the economy by credit organizations in 2016, reached to 16.4 billion AZN.

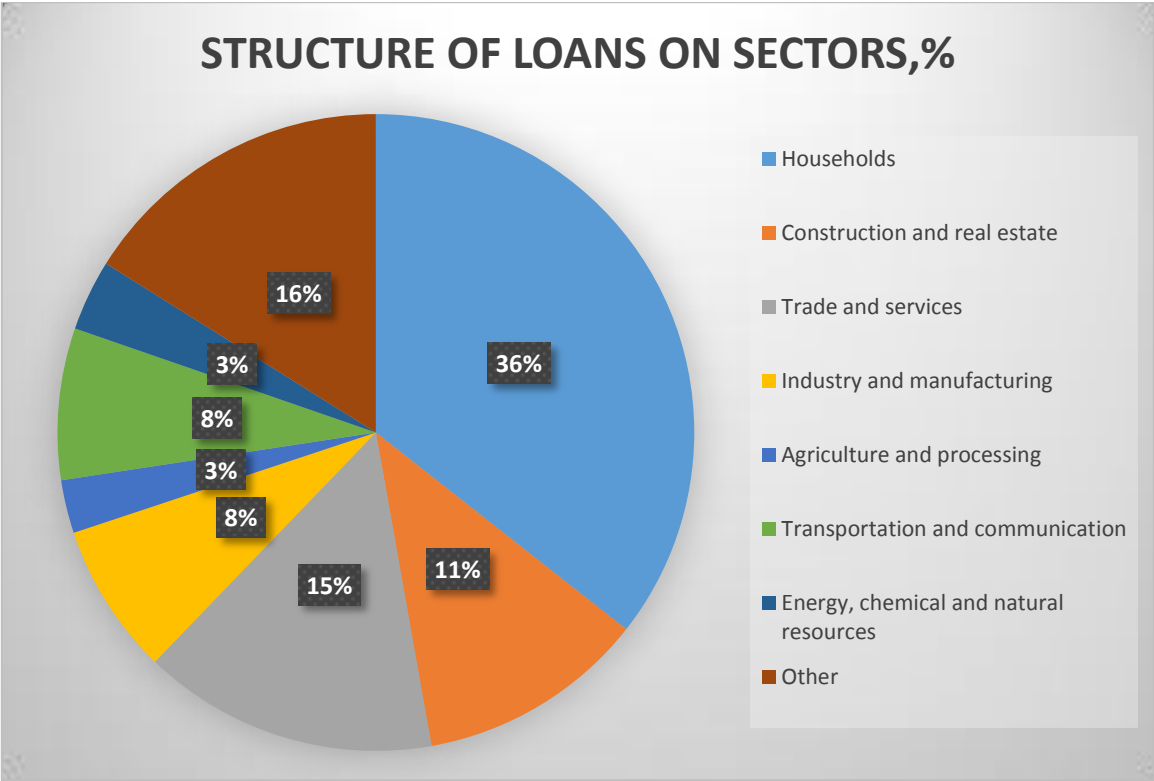
In 2016, 10 banks were bankrupt. In 2017, one bank was bankrupted. One of the bankrupt banks in 2016 was one of the top five banks in Azerbaijan. The decline in deposit and loan portfolio, and the high volume of troubled loans indicate the problems in the banking sector. The banking sector is very important for the economy, the engine of the economy. There is a need to improve the banking sector. Researches show that there are currently banks that can not fully perform their function. Even if we pay attention to the official announcements of banks, there are banks that have been working in recent years. Unfortunately, a special program has not been adopted for the rehabilitation of banks and the development of banks. There is a need to develop a special program that provides the systematic functioning of the banks by the Financial Markets Control Chamber. American experience shows that with such a program it is possible to solve problems of banks, toxic assets, as well as problems of bad loans. From this point of view the Chamber needs real steps that we can observe in the banking sector.

According to the Chart, we are clearly seeing that between 2010 and 2017 years, there is a significant increase in bad debt portfolio of country.

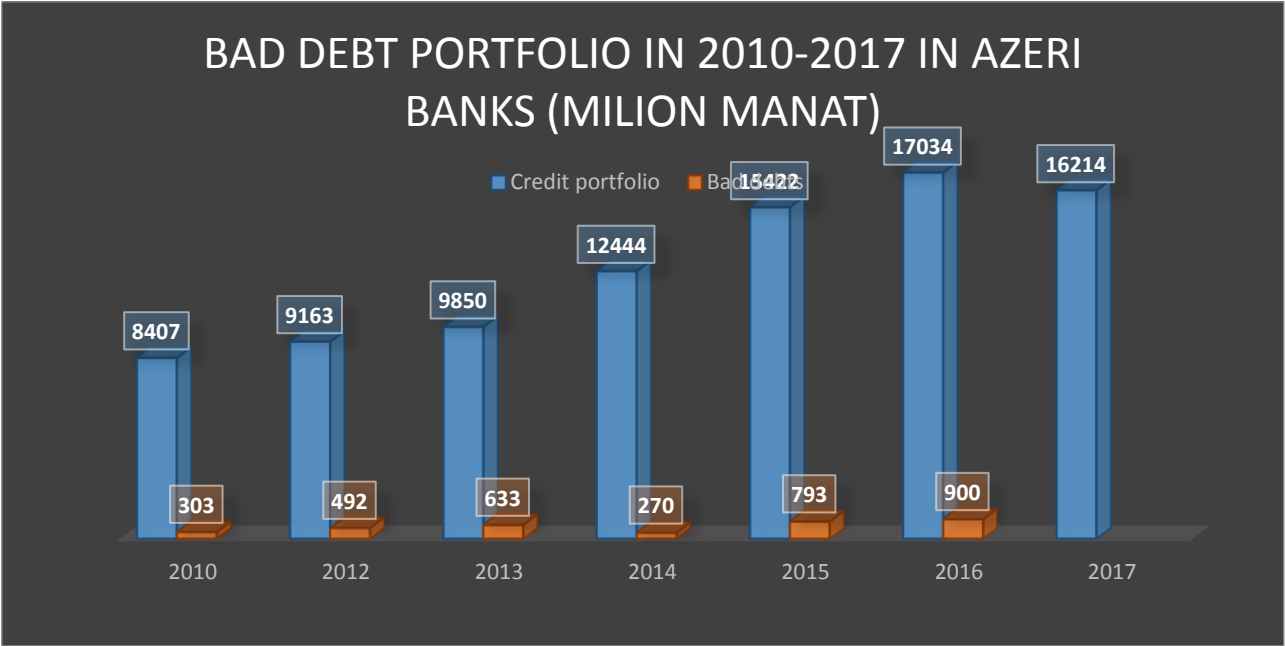


Most of the loans, ie 62.2%, were issued at the expense of private banks operating in the country (10222 million manat). The share of state banks in this indicator was 35% (AZN 5749.2 million) and non-banking credit organizations accounted for 2.9% (AZN 473.4 million).

Statistical data shows that in the reporting year, 8663.1 mln. in national currency - 7781,4 mln. and in foreign currency. The bulk of loans directed to the national and foreign currencies in the economy is 5665,9 mln. manat (76%). In the reporting year, 35.6% of loans directed to the real sector were directed to households, 15% to trade and services, 11.6% to construction and property, 7.7% to industry and production, 7.7% 3.6% to energy, chemical and natural resources, 2.7% to agriculture and processing, and 16.1% to other spheres.



According to the Chart, we are clearly seeing that between 2010 and 2017 years, there is a significant increase in bad debt portfolio of country.



The share of bad loans in Azerbaijan's banking sector is at an acceptable level in international comparison. In comparison with some Eastern-Europe countries and Middle-East countries, we can see that in Azeri banks, the shares of bad loans in total loans (5.3%) are less than the other countries. (Chart 2)

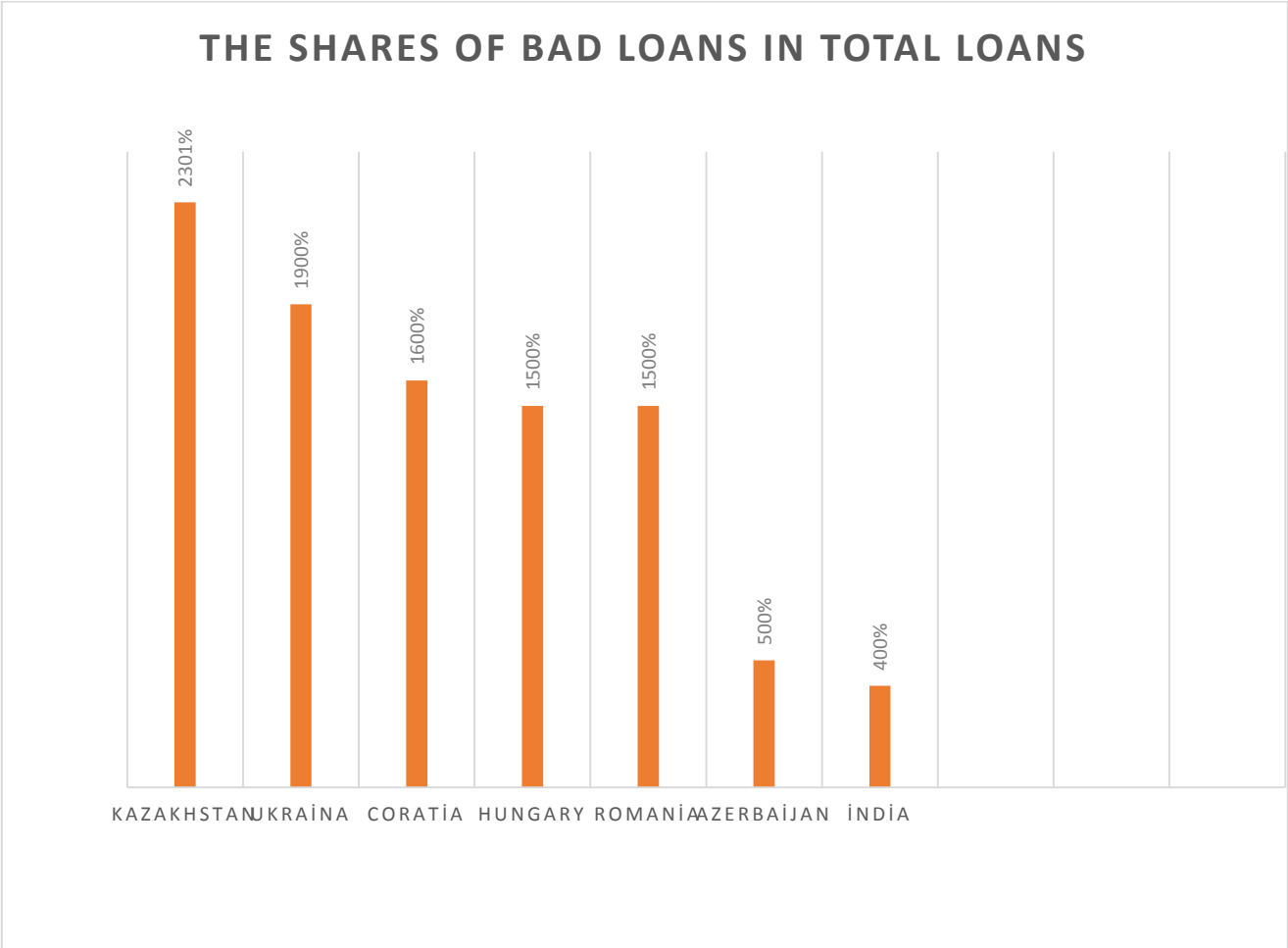


Chart 2.

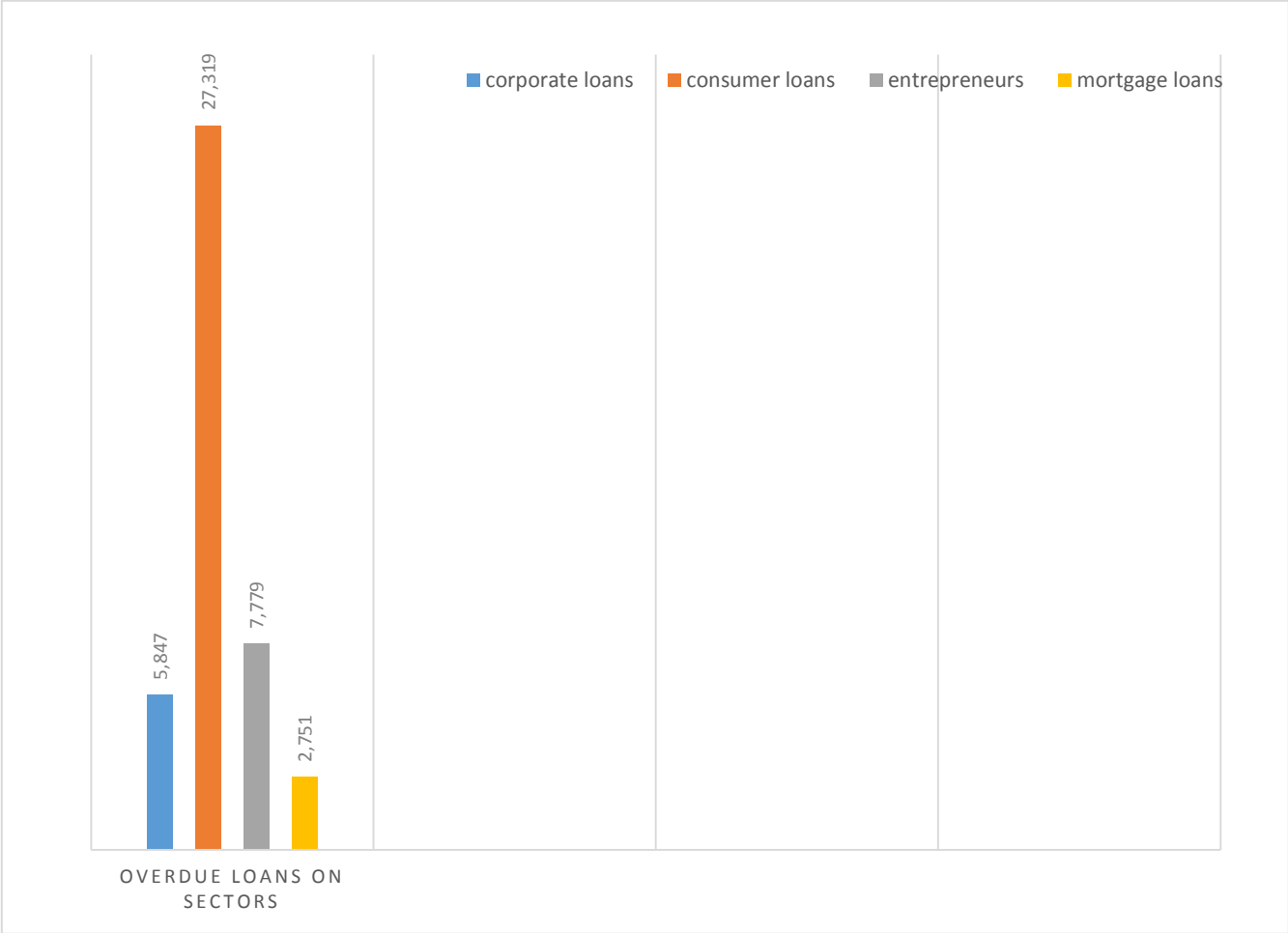
(23.6% 19.0% 16.7% 15.6% 15.3% 5.3% 4.3%)

In order to investigate bad debt problem in Azerbaijan, we have to explore separately a couple of banks' credit and bad loans portfolio in the country.

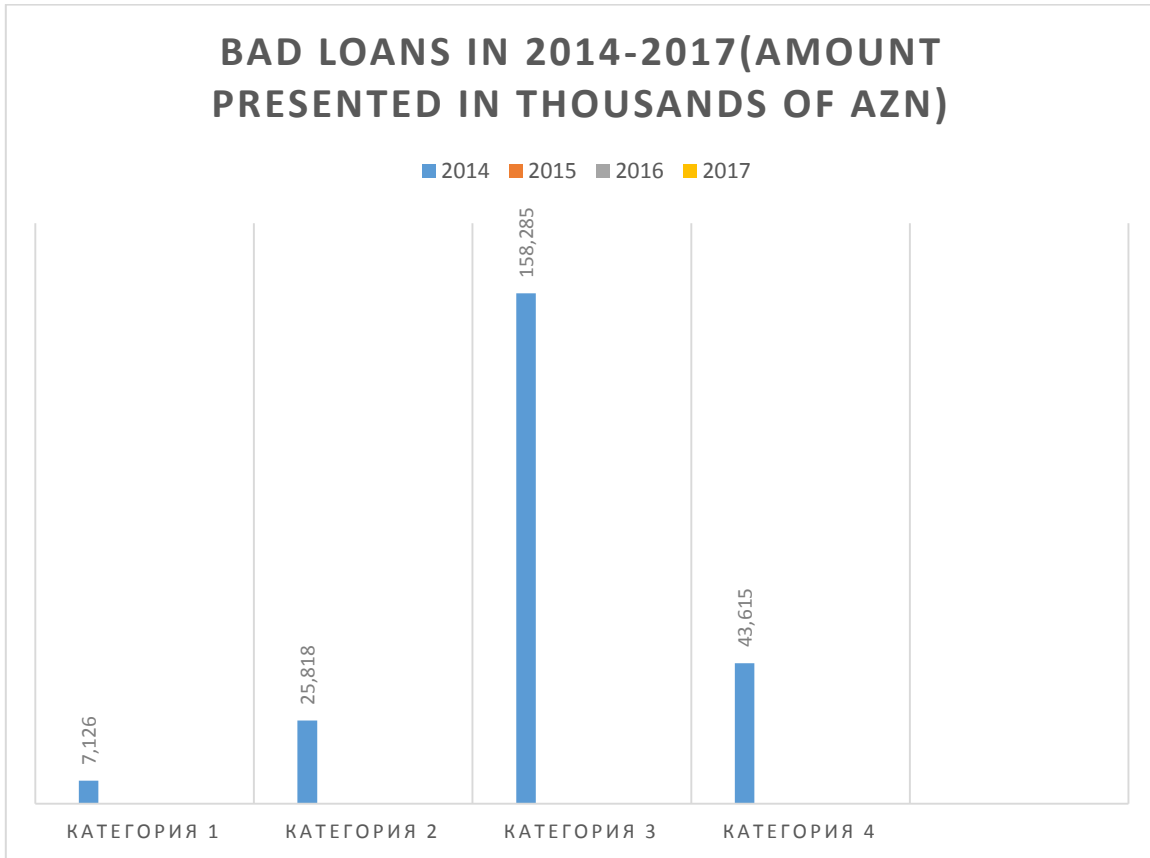
In order to investigate bad debt problem in Azerbaijan, need explore separately a couple of banks' credit and bad loans portfolio in the country.

Initially, need to have a look on Kapital Bank’s data, which is one of the largest bank among Azeri banks. This bank founded in 1987 and now serving to more three million customers across the country. According to the reports, the bank has 1,243,981 AZN credit portfolio which is the third highest amount of portfolio after International Bank of Azerbaijan(1,784,359 AZN) and Xalq Bank(1,312,223 AZN). Bank has 92 branches across the country and headquartered in Baku.

According to the reports of the banks, structure of overdue loans on the sectors in 31 December 2017 as following chart:

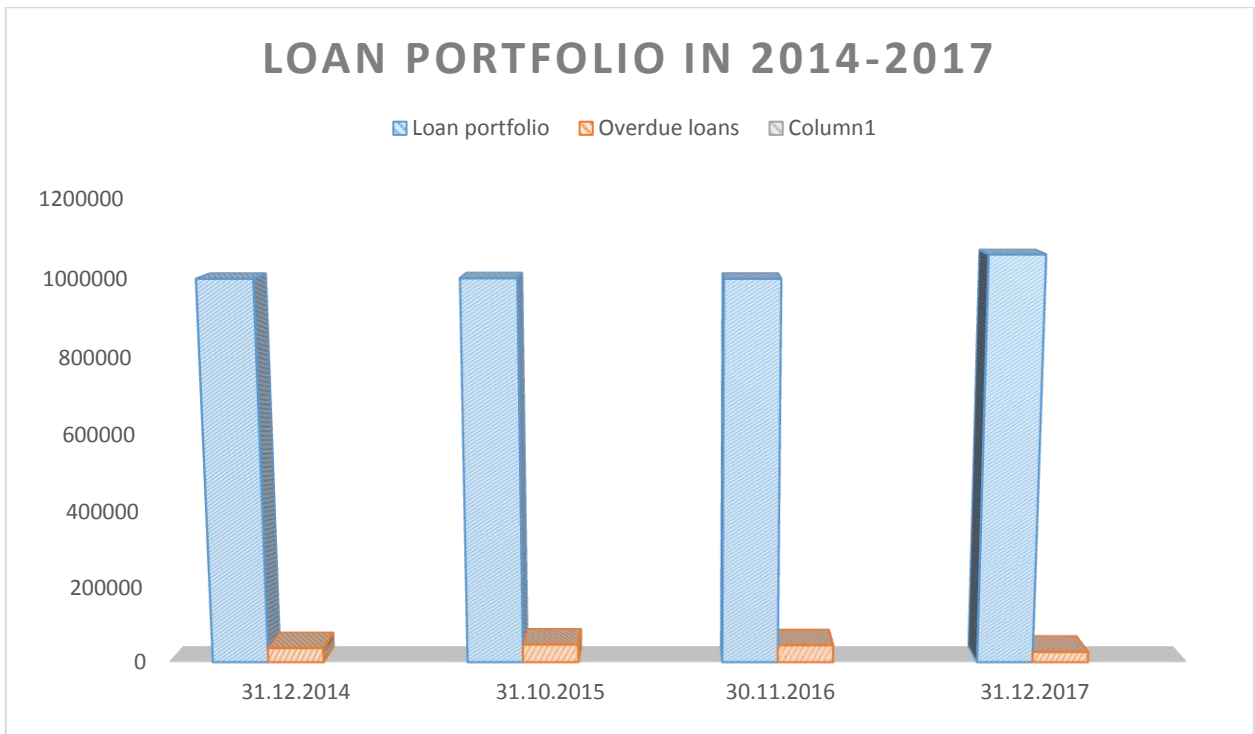


In the chart, it is clear that consumer loans have the biggest part on loans that reported as bad loans. The total amount is 43,615 AZN on bad loans and comparison to last year’s report on bad loans it is satisfactory.

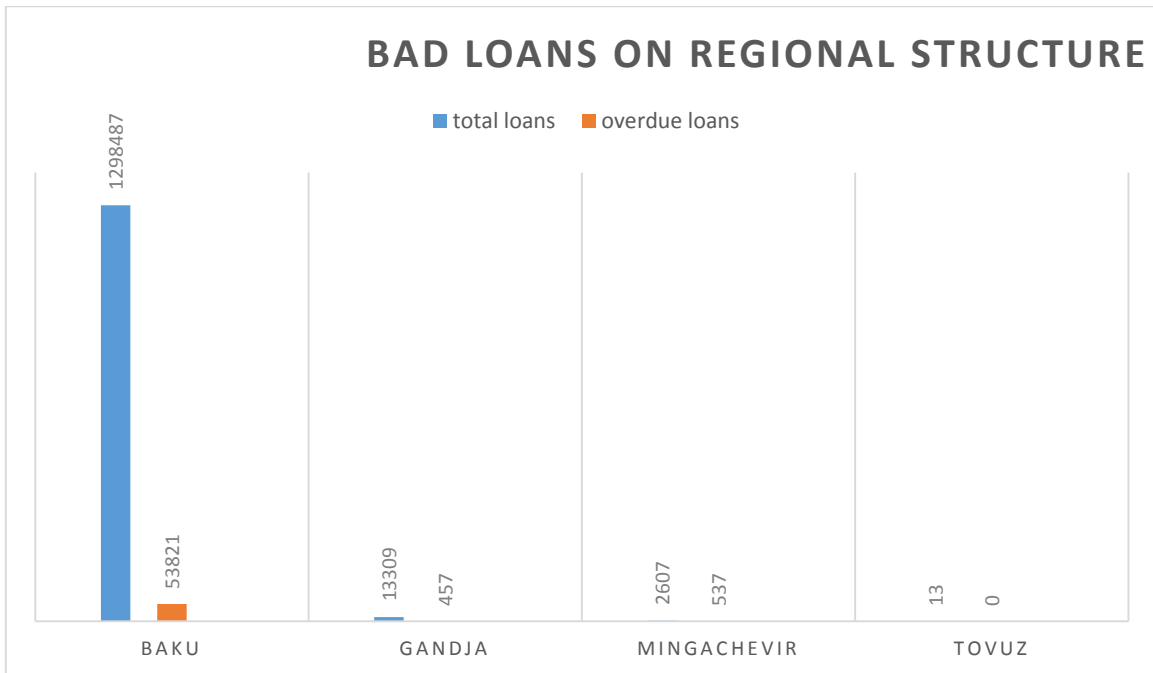


According to the chart, it is noticeable that after two devaluation in 2015, there is distinguishable increase in amount of bad loans in the bank.

Secondly, “Xalq Bank” has been among the five most powerful banks of Azerbaijan within 5 years of its existence. Thus, the authorized capital of the bank is AZN 72,828,000 and assets AZN 534,488,691. “Xalq Bank” is one of the top three banks in Azerbaijan, for both individuals and legal entities.



According to the amount of deposits placed by individuals (August 2010), “Xalq Bank” is the second largest deposit bank. Xalq bank’s have second biggest loan portfolio (1,338,158.03 AZN) among Azeri banks.

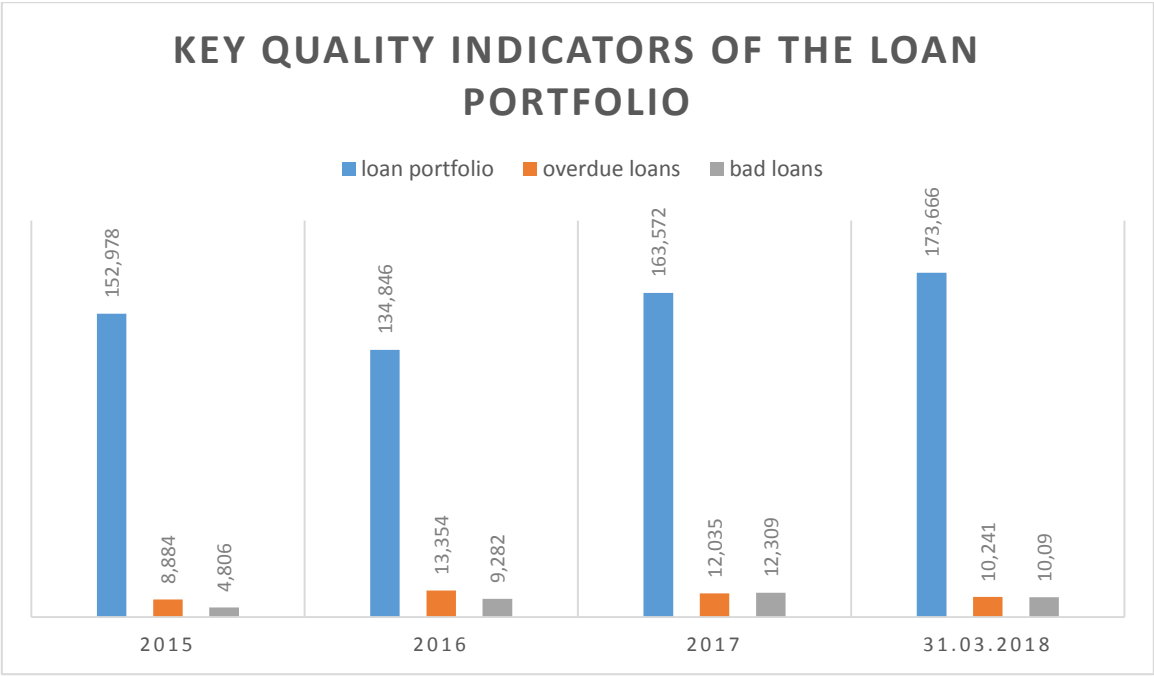


According to the chart, it is noticeable that as “Kapital Bank” the biggest part of loans has given to costumers from Baku and accordingly the highest overdue loans is belonging to this region. The least part of loan portfolio is belonging to Tovuz strict.

NBC Bank is one of the private banks in Azerbaijan. Additional service network of NBC Bank's head office consists of 11 branches and Sahil department, including Sumgayit, Ganja, Sheki and Lankaran branches, operating in Baku, Center, Nasimi, Babek, Yasamal, Ganjlik, Ahmedli and regions.

NBC Bank OJSC, European Bank for Reconstruction and Development, IFC, ADB (Asian Development Bank), ICD (Islamic Development Corporation), DWM (USA), Societe Generale, Oikokredit (The Netherlands), USAID, BankWorld, HVB Bank, Raiffeisen Bank, Austrian Creditanstalt Bank, Aizkraukles Bank, VTB Bank, Akbank and other leading foreign banks and financial institutions.

According to the financial reports of bank on loan portfolio, total amount of loan of bank is indicated 173,666 AZN in 31 March 2018. Following chart demonstrates the structure of loan portfolio:



As illustrated in pie chart, we can see that there is bad loans levels are quite normal according to 4 years reports. However, like the other banks in Azerbaijan, in NBC Bank has increase in bad debt portfolio in 2016 because of two devaluations. Loan portfolio in the sectors of economy (NBCBank report 31.03.2018)

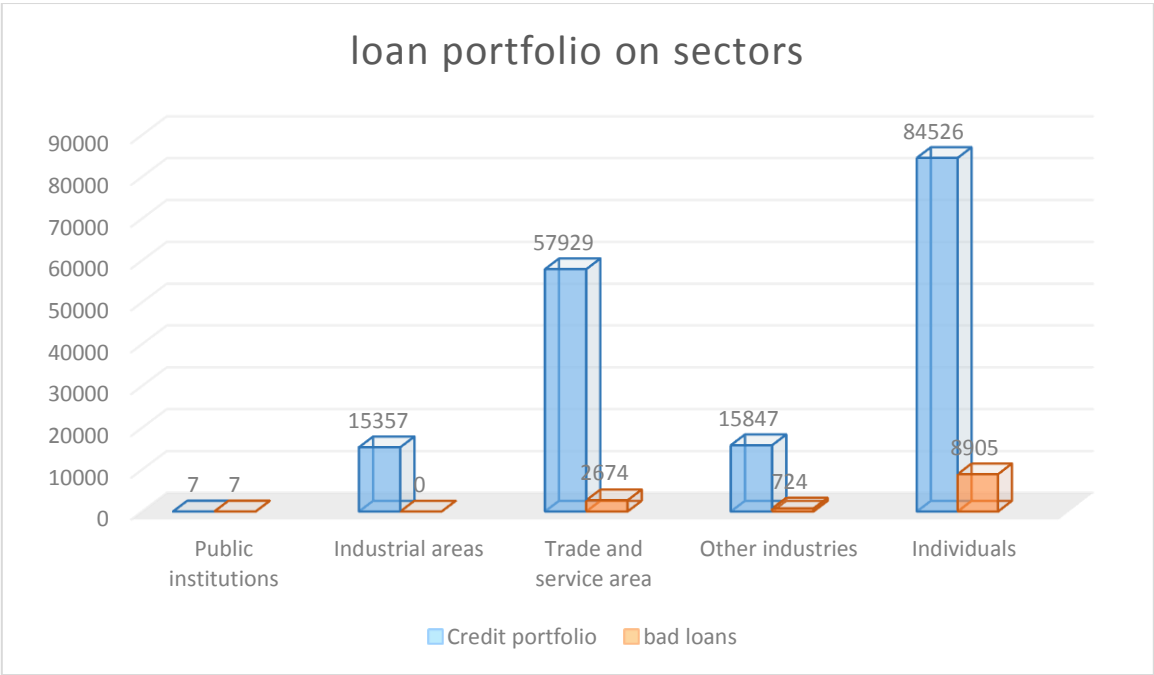
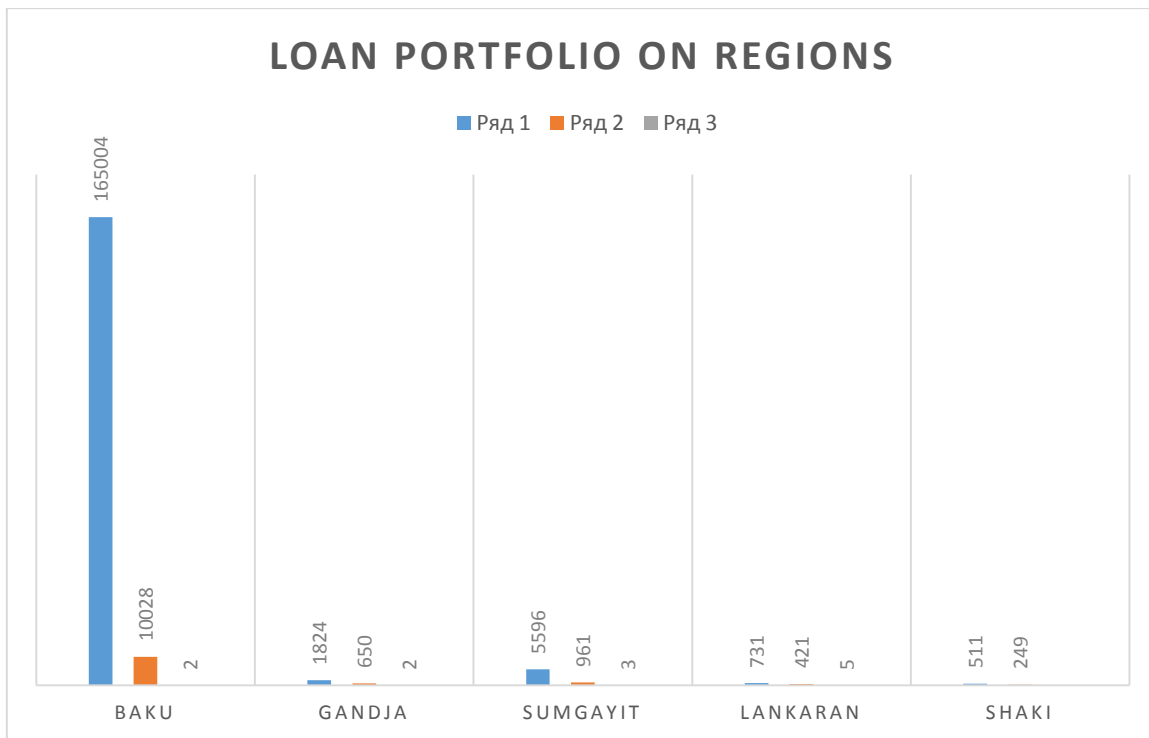


Chart demonstrates that the biggest part of loan portfolio is consist of credits to individuals. That level of consumer credits is characteristic for majority of Azeri banks. According to this levels of loans, the level of bad debts are also the highest. After consumer credits the highest is trade and service loans. It is interesting that loans on industrials areas have not bad loans, by contrast with public institutions, in this sector all amount of loans are overdue loans.

Loan portfolio on regions on NBC report in 31.03.2018



According to the chart, we can see that the biggest part of loans is belonging to Baku region. The reason why most of banks' headquarters are located in Baku and most of people live here. That's why demand to loans are highest. Therefore, bad loans' level is the highest among the regions.

International Bank of Azerbaijan case:

The International Bank of Azerbaijan (IBA) is the state-controlled and banking institution of the Republic of Azerbaijan. The bank's headquarters are located in Baku, the bank has 36 branches and 95 service points in more than 40 cities. Among the banks in the South Caucasus, IBA has the largest assets, customer base and portfolio of international operations. IBA has over 30,000 corporate and 400,000 individual customers. Many large and medium-sized enterprises operating in the territory of the Republic of Azerbaijan are IBA clients. In the structure of problem loans of IBA, 18.6% are overdue, and 9.2% fall on newly formed loans, whereby the customer re-negotiated with the bank to repay the loan repayment terms. The IBA has more than 1,300 employees. IBA is one of 1000 largest banks in the world in 2013, according to the Cistern Finance.

In 2015, the International Bank of Azerbaijan had become the most discussed bank in the country. One of the main reasons for this is the decision to arrest a few well-known business people who are in debt. They have damaged up to 6 billion manat through the International Bank. According to the published information, entrepreneurs who are involved in the investigation and pay the debt are not arrested. Those who do not pay debts are arrested and their property is categorized.

The International Bank had very big problems, the main problems were over past and bad loans. Researchs show that the root of the problem is far ahead of the previous period. It should be noted that the volume of bad loans of the International Bank is more than the volume of other bad loans throughout the country. It is true that the official statistics of the Central Bank show that the volume of bad loans is lower, but in reality these figures are much higher. In the initial period, if the figure was about one billion manat, and now we are referring to the press, we will see that this figure will rise to several billion manat.

Perhaps the biggest blow of devaluation has hit the International Bank. Failure to comply with the currency position suddenly hit the International Bank. We have

already mentioned that there have been problems before, the volume of bad assets has increased and the devaluation has hit the bank a bigger blow.

Now, there is a situation where the International Bank's bad assets are estimated at about \$ 6 billion AZN in various sources. The Bank does not yet disclose official figures. The Bank's loan portfolio is approximately 7 billion AZN and is 6 billion AZN more than that of the portfolio.

Of course, first of all, need to change management in order to solve these problems in bank. In my opinion, the biggest problem of the International Bank of Azerbaijan was the risk management failure. Large amounts of money are given and their return today is questionable. It's true, unconventional methods are used. Bank is trying to get the money back, and maybe some of the money will be saved. In general, it will not be possible to save all of this money. I think that this factor will also affect the Bank's further ratings.

The Bank's restructuring plan, dated April 17, aims to change the terms of the debt. Preparation of the restructuring plan in April was started in accordance with the Azerbaijani legislation after the amendments to the Law on Banks on 12 December. This may include changes that may result in debt repayment, lower interest rates, and forgiveness of some of the debt. After that problems in bank, the government took measures include the government's repayment of IBA's bad debts, liquidity support, and recovery of capital losses. Already \$ 9.93 billion AZN toxic asset of the bank was purchased by the state, and the bank was provided with \$ 1.3 billion for liquidity support and 70 million deposit is placed in manat.

3.2 Results

As we know, devaluations in the country over the course of a year (21.02.2015 and 21.12.2015) have greatly affected the nation's economy, especially the financial and banking sectors.

After devaluation banks' credit and deposit portfolio began to decline drastically. Also, the quality of the loan portfolio has dropped. The reasons for the decline in the quality of loan portfolio are the sharp increase of the monthly payments on loans issued in foreign currency (mainly in dollars), the increase in other consumer spending, the reduction of workers' losses in the companies, the large losses suffered by small and medium entrepreneurs. the factors affecting the solvency of customers.

As a result of devaluations, both the banks and the banks' lenders served as a loser. For this reason, banks increased their credit repayment rates, improved credit portfolio quality and at the same time took part in the loss of customer satisfaction. Thus, preferential terms of restructuring of loans received in foreign currency, as well as the application of lower rates during full repayment of these loans were offered to clients. Although over 2 years have passed since devaluation, the Bank's loan portfolio still has such loans (especially long-term loans). After devaluation discounts offered by banks for loans in foreign currency.

Reasons for the increase of problem loans (professionalism of those who pursue delayed loans, attractive ads of consumer loans, bankruptcy of entrepreneurs, etc.) may be different. If we look at the latest administrative measures taken by the Central Bank, we see that most of these administrative measures are aimed at limiting consumer loans. Here it is possible to conclude that the main reason is that citizens are under the debt burden more than their solvency and, consequently, the problem of non-payment. The solution is to put more stringent requirements into the lender's process, as well as toughen legislation against debt-delayed borrowers.

Bank diversification of loans is one of the important part of lending process and carried out by economic sectors. When financed any economic sector, within the framework of intra-bank limits, the areas not prohibited by law and less risky for the bank are funded.

It is crucial that the issue of protecting the rights of creditors in relation to problem loans is very important. In fact, the mechanism of concessions is very important for the protection of creditors' rights. Taking into account that the concession mechanism will ultimately allow the citizens who have a problematic loan and who cannot repay it. At the same time, it does not mean that we can only apply a discount when we say creditors' rights. It also deals with the improvement of the legislation protecting the rights of citizens who are directly involved in crediting. Taking into account that in neighboring Russia, there is a right of bankruptcy of physical persons to protect the rights of creditors, and we also offer it to the government. So, imagine that the bank is bankrupt and can not repay the deposit it receives. If we pay attention to Demirbank, this bank has a deposit of 28.3 million manat. Demirbank purchased, used and received income from the citizen in the form of a deposit. But it is difficult to return those 28.3 million manat, which is already bankrupt. The experience of previous bankrupt banks shows that almost impossible to return. If a bank receives a deposit, uses a revenue, and can not repay it because it is not protected, why not give citizen a right to bankruptcy. The Bank can not continue its activities, declares itself bankrupt and it is free of obligations. That is why there is a need to recognize that right to protect the rights of creditors, but it is also crucial for bank managers to be more aggressive.

In fact, the most successful party in solving the problem is the banking sector. As long as problem loans remain, they ultimately affect banks. If we look at the banks' deposit and loan portfolios, of course there are reductions. Banks are no longer interested in attracting deposits. Because there are difficulties with placing this deposit. The Bank has two main functions. Depositing and placing a loan. If the bank is not interested in

attracting a deposit, see, there are decreases in deposit interest rates in foreign currencies since 2017. If a citizen could place his / her manat in a commercial bank at a rate of 15 percent a year earlier, this figure is now 9-10 percent, and continues to decline. In the leading banks decreased by 6-7 percent. The bank is no longer interested in attracting a deposit. Because there is a risk of placing it. As a result, the loan portfolio dropped to 11.7 billion manat. From the beginning of the year, the deposit portfolio decreased to 7.3 billion manat. A year earlier, this was 7.7 billion manat. From this point of view, it is crucial to solve problematic loans and toxic assets for the recovery of banks. At the same time, the announcement of bankruptcy unequivocally is not the solution to the problem. There is a need for banks to improve the banking sector.

According to analysis of loan portfolios of Azeri banks, we clearly see that because of there are plenty of real estate and generally secured loan types, there are not many problems with its collection. In any case, the real estate can be deducted and the loan repayment can be achieved. Major problems arise from unsecured loans, which do not guarantee any of these loans. The most challenging group of people who receive unsecured loans is a group of 18 to 25 years old who have no property. It is known that their property is owned by their family. This category of people can not be referred to repayment of loans, problems are more and more in this group of debtors.

Private Banks in Azerbaijan are struggling with bad debt problem in recent years. As a result, several private banks were closed. Additionally, deposits placed by banks in the banks have drowned and caused great problems in the country.

In order to overcome the bad debt problem, there are several solutions. Therefore,

- Firstly, transparency should be ensured in banks.
- Persons working in banks should stop providing special services to their relatives or to fictional companies.
- An effort to direct and extend the loan granted to the production department is instructed and should be effectively supervised.
- Secure timely repayment of loans granted from banks.

- It is necessary to reduce the number of human resources working at public banks, teach staff to be more educated, experienced, efficient, and sensitive to customers or if needed using professional advisers.
- If banks are reorganized and given technical information, continuing public bank activities will benefit the country.
- More improved organizational structure on credit risk management and loan operations.
- Applying credit limits to customers who has already big amount of loans and has low creditworthiness.
- Applying foreign practices such as drawing bad debts from the customers' salaries, utility expenses, and several fees. If customers want pay their electricity or gas fees, t
- if the client wishes to pay for the light or gas, the bank will initially be charged with the debt

Banks are able to reduce the bad debt portfolio by selling problematic assets. Of course, it is widely spread in the world practice. Unfortunately, there are no public organizations or professional associations operating in Azerbaijan. Which, by researching the market, can stimulate the sale of portfolios in different ways and can show the benefits of selling bad debt portfolios to banks. In order to selling bad debt portfolio, there are professional organizations operating in Russia or in Turkey, and portfolio sales are billions of dollars. Thus they pursue those who do not pay their debts, and they earn from it. Banks are relieved of the problematic part of their loan portfolio. I think that in this form, banks can manage their loan portfolio more conveniently.

Conclusions

The problem is that in fact, is expected that by 2018, the volume of bad loans will not increase in contrast will decrease. Because of the current situation in the economic process, the gross domestic product growth probability and sufficient reserves in banks, it is expected that the volume of bad loans will not increase and will not adversely affect bank capital.

It is true that the existing volume of bad loans is also great, and this problem remains unresolved. The existing legislation in this direction could not solve the issue. Therefore, we need to apply international experience to solve bad loans. Can be created in any fund for solving the problem and bad loans can be managed through a single fund for solving the problem. Establishment of such a fund could have a positive effect on the return of bad loans. With the financial support of the state, the elimination of such loans can not be regarded as a viable option. This option is not accepted in international practice. Therefore, it is more appropriate to discuss the issue of returning overdue credits, mainly through any fund.

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