



Centenary
Bank

Module 4

Management of problem loans and recovery management in agricultural lending

Wasmus Consulting



Definition and measurement

- **Portfolio at Risk (PAR):**
 - o/s principal in arrears
o/s principal
 - Calculated over the principal, i.e. principal of all future instalments is considered to be at risk.
- By loan officer, branch, customer segment, activity etc.

Definition and measurement

- **Migration analysis (see module 3)**
 - Tool that analyses what volume or percentage of overdue loans migrate from one aging category to another.
 - For instance, what percentage of loans overdue from 1-30 days migrates to the critical category of 31-60 days overdue in 1 month time?
 - Helps us to interpret the effectiveness of **loan collection** and spot adverse patterns in collection early on.
 - Ideally migration analysis is measured against pre-set limits.

Definition and measurement

■ Migration analysis - calculation

	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11	Aug-11	Sep-11	Oct-11	Nov-11
1 to 30	1,935,131	2,320,994	2,592,538	2,663,674	2,797,524	2,500,743	2,707,490	2,590,905	2,194,010	2,177,431	2,298,966	2,428,209
31 to 60	434,935	476,587	531,631	374,014	465,420	487,198	457,444	376,317	334,969	378,196	472,781	478,119
61 to 90	226,621	255,278	283,031	244,271	215,527	327,555	270,308	298,817	262,952	253,661	175,615	253,791

1-30 to 31-60	25%	23%	14%	17%	17%	18%	14%	13%	17%	22%	21%
31-60 to 61-90	59%	59%	46%	58%	70%	55%	65%	70%	76%	46%	54%

Role of recovery process in the bank

- Key to generating a payment culture
- Frees up money for lending
- It is a business activity and an essential piece of the credit cycle, not just the last part.
- Receive feedback on policies and procedures
- Loan officer remains responsible

Specifics of agric loans



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that may impact recovery

- Grace periods and/ or irregular instalments
=> no 'early warning system
- Main source of loan repayment is seasonal/
irregular
- Specific agricultural risks may impact
payment
- Rural borrowers are less literate



Causes of arrears

- Within the bank
 - **Application:** product does not meet client needs;
 - **Assessment/ proposal:** failure to assess repayment capacity; failure to propose adequate terms;
 - **Approval:** committee decisions influenced by desire to meet targets; decisions are subjective
 - **Disbursement:** delays leading to lost opportunities and diversion



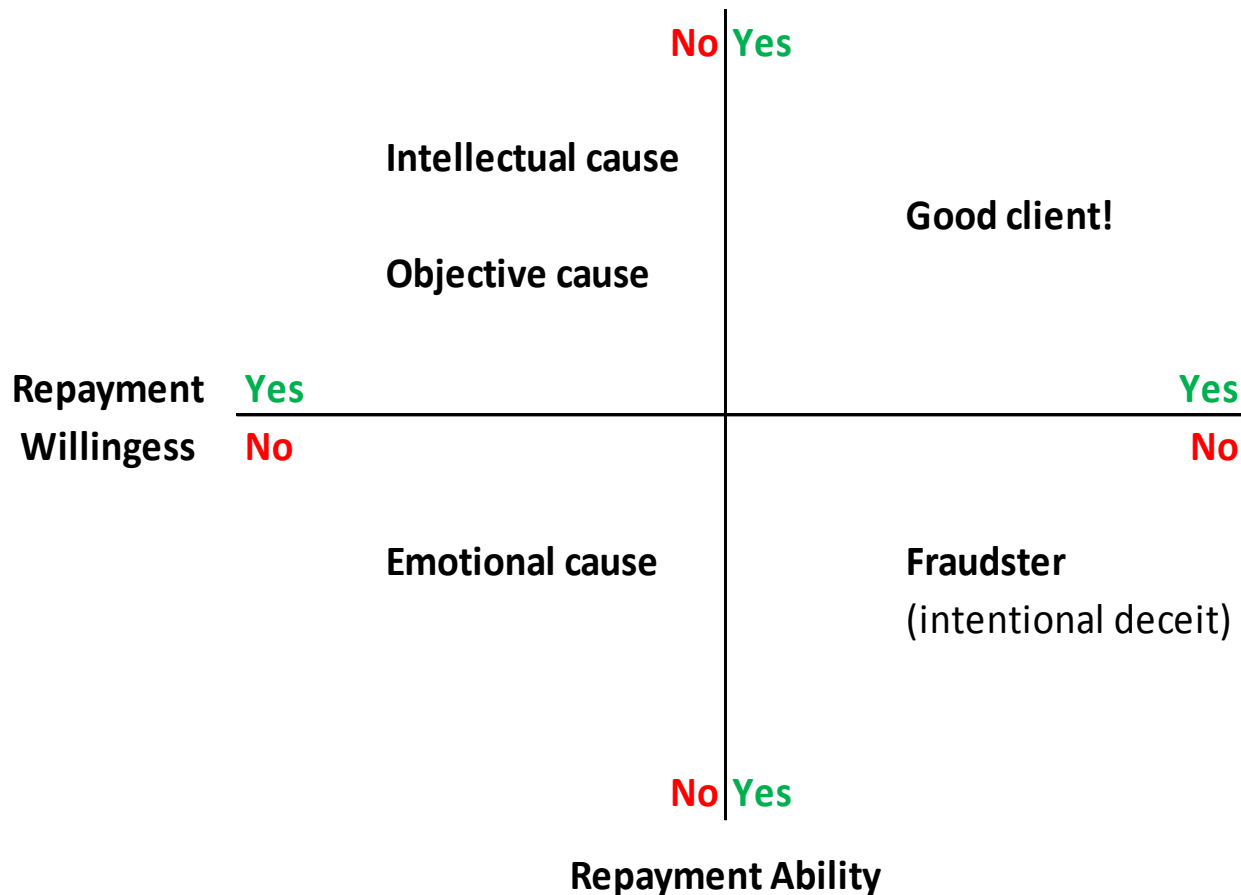
Causes of arrears

- With the client
 - **Objective causes:** loss of income (bad harvest, illness etc)
 - **Emotional causes:** clients behave as if they 'deserve' the loan and its proceeds even if they are unable to afford it
 - **Intellectual causes:** usually able to pay but have trouble budgeting
 - **Intentional deceit:** clients with a criminal mindset – no intention of paying back

Repayment willingness and ability

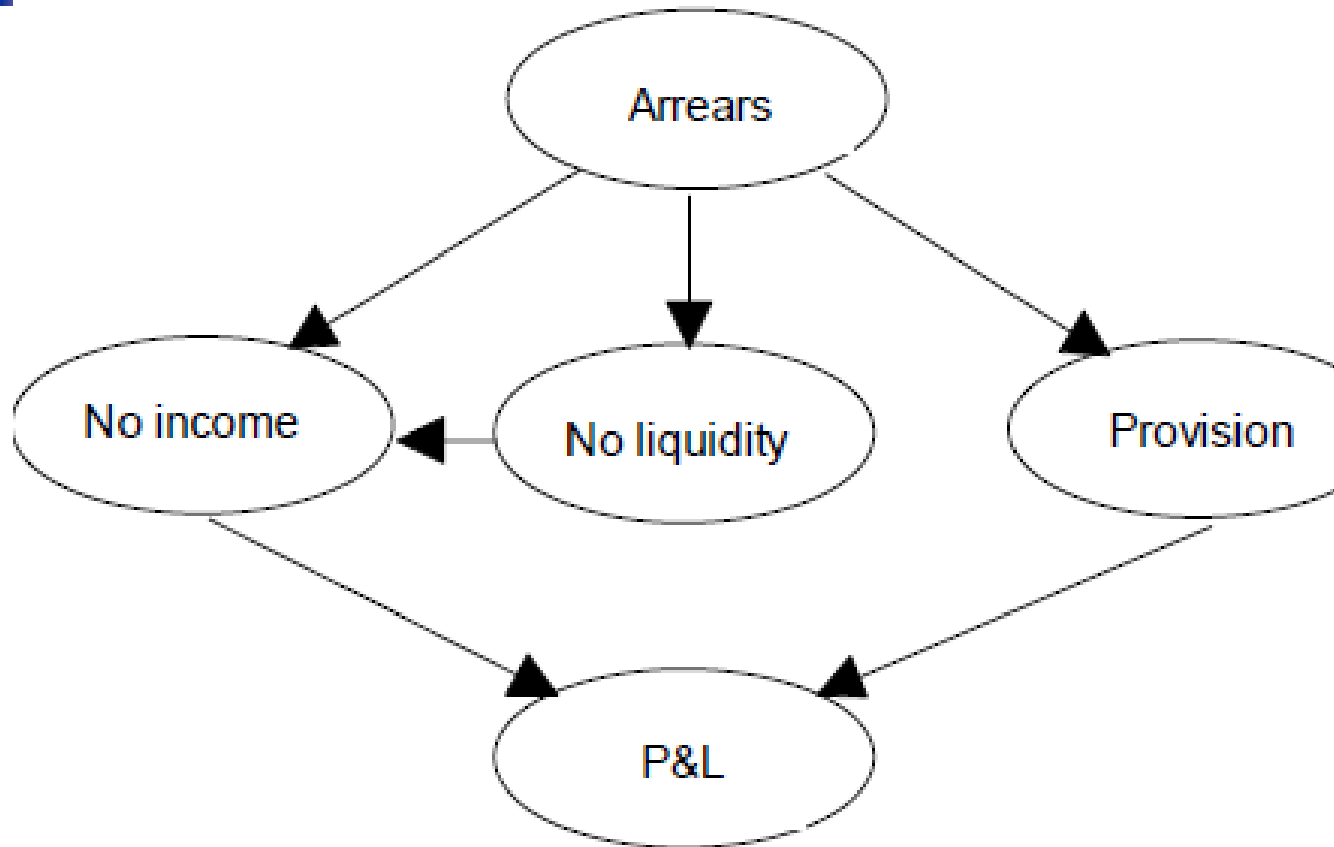


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Consequences of arrears





Prevention is better than cure

- Key elements of arrears prevention
 - Base loan decisions on repayment capacity
 - Stick to policies and procedures
 - Explain obligations to client
 - Regular monitoring!!
 - New clients
 - Agric clients with grace period
 - Agric clients with irregular payment plans
 - Incentives for loan officers
 - Fair treatment of clients

Performance targets and measurement in recovery

- Based on amounts recovered => may not solve arrears
- Based on PAR reduction => may not bring liquidity in
 - Measurement: f.i. PAR60 end of June should be lower than PAR 30 end of May (assuming no write offs)
- Consider 'hybrid' system



"No, don't put the cheque in the post - I'll send someone round to pick it up."

Practice of recovery

- Recovery process is defined as the set of coordinated, appropriate and timely activities aim at full recovery of loans from clients



"I believe they're a debt collection agency."



8 principles of recovery

1. Analysis of the borrower's past payment history prior to first contact
2. Validate the debt;
3. Listen to the client and understand the root cause of the problem;
4. Obtain a Promise to Pay (PTP);
5. Always follow up immediately if a client is overdue or misses a PTP;
6. Intensify/ escalate recovery activity if a client misses a PTP;
7. Offer repayment alternatives to stay on speaking terms with the client;
8. Contact all individuals related to the loan.

1. Analysis of the borrower's past payment history prior to first contact

- Was borrower delinquent previously?
 - At the same time in the season?
 - Consider to check credit bureau
 - Check if there is collateral, guarantors, co-borrowers
 - Any conditions set/ remarks by Credit Committee?



2. Validate the debt

- Make sure the client agrees on the amount due, including interest and principal if applicable
- If the client disputes the amount due, find out where the problem is:
 - Payment has not been recorded?
 - Misunderstanding?
 - Gave money to someone else?

3. Listen to the client and understand the root cause of the problem

- What is the client's financial situation?
- What are his current sources of income?
- Why did the loan fall past-due?
 - Are the reasons for default primarily caused by the bank or by the client?
 - If by the client, are the reasons for default objective and verifiable?
- Is the client not willing or not able to pay?



4. Negotiate and obtain Promise to Pay

- Key recovery activity of a LO
- Always obtain a Promise to Pay specifying amount to be paid and the date;
- Due date of PTP shall be before 30 days late and/ or before the next instalment is due;
- When possible, PTP shall be in writing (use client contact documentation form)
- Record PTP **in diary** and follow up if client misses payment.

5. Always follow up immediately

- As soon as client is 1 day overdue, there shall be contact.
- If client misses PTP, there shall be contact.
- Failure to follow up will be seen as sign of weakness!
 - “The bank **doesn’t know** that I am late”
 - The bank **doesn’t care** that I am late



6. Record each interaction with the client

- Each interaction (phone, sms, in office, business, home, on the street etc.) shall be recorded;
- Different bank staff may be in touch with the client;
- Record in loan file (if not in CBS or collection software).

7. Offer an alternative to stay on speaking terms with client

- While you have to convey clear messages on behalf of bank, it is key to stay on speaking terms with clients.
- When clients don't pick the phone or hide, collections becomes very difficult
- Offer:
 - PTP
 - Rescheduling or restructuring (see separate section)

8. Contact all individuals related to the loan

- In order to have maximum impact of collections work, all individuals related to the loan shall be contacted:
 - Co-debtor
 - Guarantor(s)
 - Family members (if legally permissible)

Centenary procedures

- **Regular follow up/ monitoring:** Loan officers have to follow up for payment of installments regularly.
- **7 days late - first recovery notice:** If payment is delayed by 7 days, AO (accounts officer?) has to issue the first warning letter to bring the account in order within 30 days. (note: not all branches follow this procedure)
- **30 days late – second recovery notice:** AO shall send a second letter giving 45 working days to pay the entire outstanding amount plus accrued interest.
- **30d+45 working days late – third recovery notice (Notice on default):** Official notice of sale of mortgaged property after 21 days from receipt of the notice (as per mortgage regulation).
- **30d+45+21 working days late – Instructions to auctioneer.** The auctioneer shall give the client 30 days to respond and settle the amount due. If the client does not pay, the auctioneer shall go ahead with the sale.

Rescheduling and restructuring

- Rescheduling: granting of additional time for loan repayment (lowering instalment amount)
 - Maximum loan period: 2 years
 - Site visit and verification needs to be done
 - Proposal to HO for sanction at appropriate level.
- Restructuring may go beyond granting additional and may involve:
 - additional finance (max 2 loans o/s at same time)
 - Waiver of penalty
 - Foregoing part of interest due.

Rescheduling and restructuring

- Needs to be seriously considered if:
 - The cause of arrears lies in a **poorly structured loan**, for instance if the payment plan that is given by the bank does not meet the client's seasonal cash flow;
 - The cause of arrears lies in a **poor harvest** and a significant part of the income and repayment capacity stems from that harvest;
 - Untimely **death or illness of livestock or poultry** and a significant part of the income and repayment capacity stems from livestock or poultry.

Rescheduling and restructuring

- Simple pre-condition:
 - Borrower has sufficient capacity to repay the instalments of the rescheduled/ restructured loan;
 - It is a waste of time to reschedule/ restructure a loan if there is insufficient repayment capacity.
 - If assessment shows clients needs more funding, and he can pay, consider
- Appraise as new loan

Recovery process

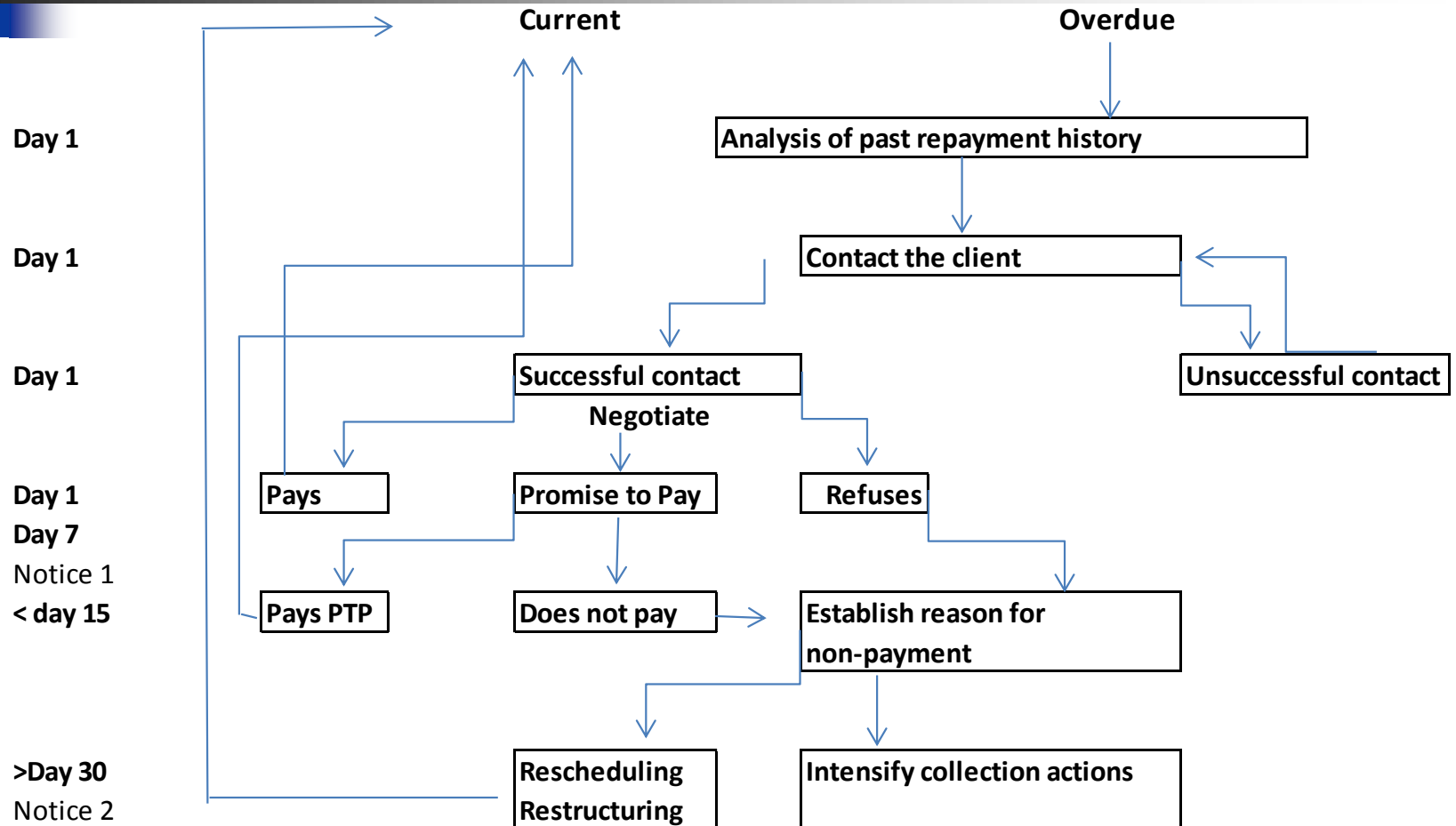
1-30 days late

■ Focus on:

- Immediate client contact on the day the client is overdue (day 1);
- understand the reasons for default;
- Following the bank's procedures a first recovery notice shall be issued on day 7;
- Obtain a Promise to Pay that falls due before the client is 30 days in arrears and record it properly;
- If the due date of the PTP is missed, intensify collections actions, for instance through 'group recoveries'.

Recovery process

1-30 days late

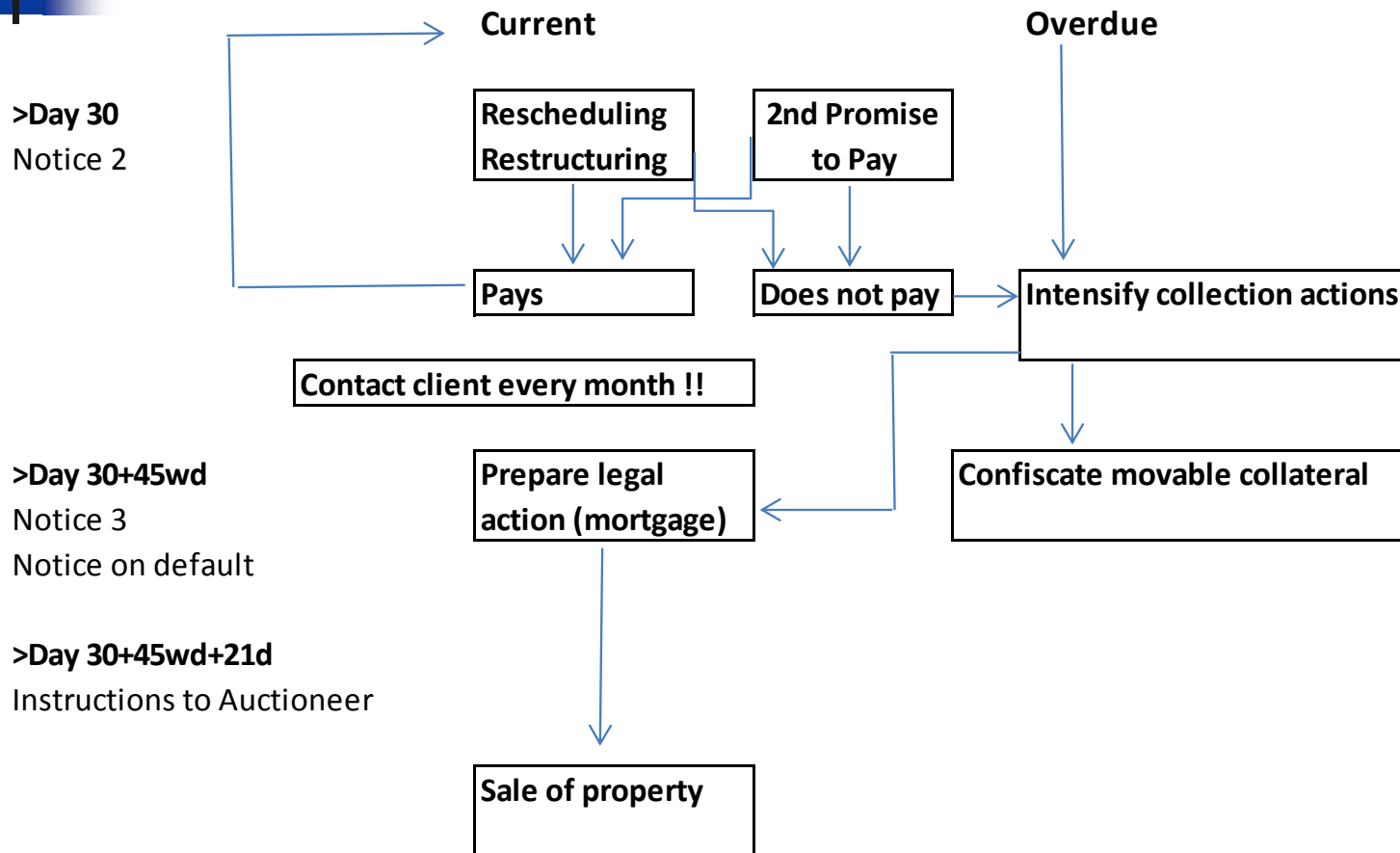


Recovery process

> 30 days late

- Needs to be intensified once > 30d late (group rec.)
- All steps 1-30d should have been taken
- Consider another PTP
- Bank procedures:
 - 30d late – 2nd recovery notice
 - 30d+45wd late – 3rd recovery notice (Notice on default)
 - 30d+45wd +21d late – instructions to auctioneer to proceed with sale of property.
- Continue to contact clients once per month!

Collections process > 30d late



Role of collateral

- Movable
 - Main role is that of ‘credible threat potential’
 - Role in actual collections should not be overestimated:
 - Difficult to sell
 - Has reduced in value; amount may not be enough
 - Has disappeared
 - Clients may be happy to have bank sell
 - Important that all other collection steps have been taken before sale is attempted.

Role of collateral

- Immovable
 - Generally considered good security
 - Crucial that all steps have been followed
 - See mortgage act of 2009 and mortgage regulations of 2012.
 - Freehold, leasehold and customary land (Kibanja)
 - Risks associated with Kibanja are higher than with titled land.

Recovery of written off loans

- Policy

- *Write off of a loan in the books of the bank should not be misconstrued that the bank would be giving up its legal right of recovery against the borrower. Loan officer should persist with his recovery efforts against such borrowers”.*

- Recovery of written off loans is direct income to the bank!

Exercise: Your superior instructs you to recover 15% of written off loans of your branch before year end. Design a strategy and process to make this happen.



Recovery of written off loans

- Good measurement is essential
- Consider specialized staff
- Aim to have a ‘closed system’:
 - Client is paying - or -
 - Loan is subject to a PTP – or -
 - Loan is subject to court procedures
 - => no loans should fall outside these categories!
- Consider systems of discounts for clients
- Consider incentives for staff

Psychology of loan recovery

- Communication skills are key to the success of loan recovery
- Treat client with respect and dignity
- Use insights from ‘transactional analysis’
 - One of the most accessible psychological theories
 - Wide application
 - Each of us has different parts of our personality that surface and affect our behavior in different circumstances



Three ego states

- Everyone has 3 ego states that control communication with other people:
 - Parent
 - Adult
 - Child
- No 'good' or 'bad' ego state;
- need all 3 to be normal, healthy human beings

Three ego states

- Need to understand why people react the way they do;
- By understanding Transactional Analysis you will be able to handle most situations professionally;
- Get clients into 'Adult ego state' and use their problem solving and objective train of thought to come to a positive resolution;
- Recovery can be easier if you understand the psychology behind it.



Parent ego state

- Parents are nurturing and judgmental
- They tell us what to do, when to do it and how to do it
- Parents can be critical, point out errors of our ways and let us know that we are headed for trouble.
- The parent ego state is where collections often fail
 - Collector tries to be judgmental and controlling
 - As a reaction, client goes into child ego state
 - Client is on the defense and lies
 - You get a lot of broken PTPs when client is in child ego state; they will do anything to get collector away/ off the line.



Adult ego state

- Adult ego is our objective, logical thinking
- This is where we sort out information, make decisions and solve problems.
- Problems get solved in adult ego state (x2).
- By using adult ego state when collecting, collector can:
 - Refer back to signed loan agreements and/ or PTP.
 - Reason on importance of meeting their obligation
 - Use negotiating techniques to come to arrangement.



Child ego state

- Child ego state is our fun-loving, creative and emotional side.
- Can you reason with a child when they are having a tantrum?
- When a client becomes irate, discontinue the conversation and let a supervisor take over
- Once client is passed over, he will go back into adult ego state.



Applying these insights

- Do not communicate with attitudes or words that come from the Parent Ego State: they will probably trigger the Child Ego State in the receiver (the client);
- If you communicate in the adult ego state the client will react with the same problem solving ideas. **Get into your Adult Ego State and stay there!** Be logical: ask questions that start with: WHO, WHAT, WHERE, HOW and WHY. These are information gathering and fact finding questions you need to be able to solve problems;
- The more you stay in your Adult Ego State, the better chance you have of getting the client into his/her Adult Ego State.



Applying these insights

- Use information gathering questions
- Build an atmosphere in which client opens up: objective and logical reasoning keep people calm
- Let the client speak
- **Recovery is 80% listening and 20% talking**