ST. KITTS BRANCH
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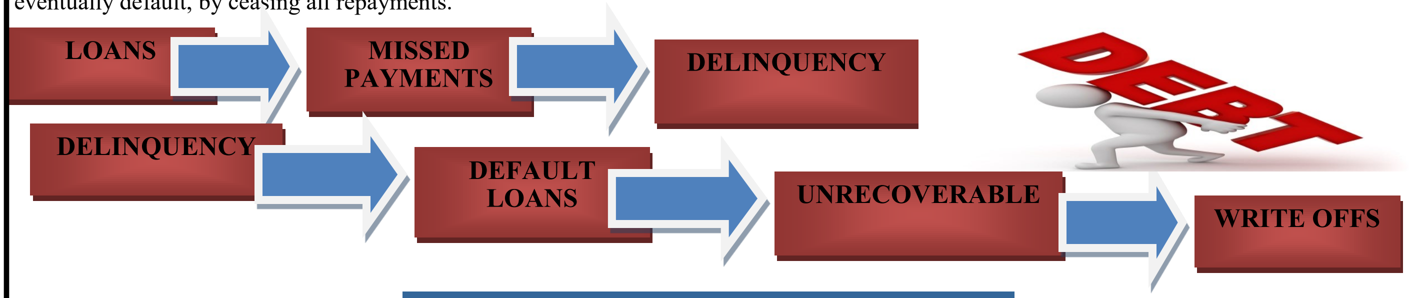
MANAGING DELINQUENCY

WHAT EVERY FINANCIAL INSTITUTION SHOULD KNOW

When a borrower fails to meet his/her contractual obligation as it is due, the borrower's payment is deemed to be late. Delinquency is said to occur when payments are made late (even by one day) or regular payments are missed. It is measured by the financial institution because it indicates an increased risk of loss, provides warnings of operational problems and it would assist in predicting the percentage of the portfolio that would eventually be unrecoverable due to non repayment. Pearson and Greeff (2006) notes that consistent delinquency, where at least three payments have been missed in a 24 month period, signifies a behavioural pattern hence there is demonstrable increase in the risk that the borrower will eventually default, by ceasing all repayments.


LOANS
MISSED PAYMENTS
DELINQUENCY
DELINQUENCY
DEFAULT LOANS
UNRECOVERABLE
WRITE OFFS

CAUSES OF DELINQUENCY

INTERNAL FACTORS

- **Noncompliance With Established Lending Policies**– Loan Officers granting loans to borrowers without full consideration of the requirements in the lending policy of the Financial Institution.
- **Insider Lending**– Loans granted to related parties (directors, management, board members, etc) without following proper lending procedures.
- **Improper Loan Appraisal Techniques-** The formulation of inappropriate judgments while assessing the viability of the loan purpose. Examples may include the amplification of a project's productivity, lack of or inadequate security, unrealistic terms and schedule of payments.

EXTERNAL FACTORS

- **Individual Crisis-** Unpredictable individual circumstances increases the risk of delinquency. Situations may include the death of relative, unemployment or salary reduction.
- **Natural Disasters-** Floods, Hurricanes and Earthquakes may deter profitability of projects and also give rise to restructuring of disposable income.
- **State of Economy–** An economy in a recession can affect delinquency. Recessive economies face liquidity problems hence expected loan repayments would be negatively affected.
- **Transaction Cost of Loan-** High transaction costs lead to the reduction of funds to execute projects. Projects that are not fully capitalized may be compromised, consequently affecting the repayment process.

EFFECTS OF DELINQUENCY ON FINANCIAL INSTITUTION

-Slow rotation of loan portfolio –Delayed repayments

-Reduction of Financial Institution Assets due to write off loans

-Delayed Earnings

- Increase in Loan Loss Provisioning

-Loss of Credibility to Lending Programs/ Institutions

- Decreased Long-term institution viability

-Increased Collection Cost

DELINQUENCY INDICATORS

Delinquency monitoring is an important aspect as it is a crucial analytical tool which involves the use of the Delinquency Ratio. The Delinquency Ratio refers to the percentage of loans within a financial institution's loan portfolio with delinquent payments.

There are 3 types of Delinquency Indicators:

- **Collection Rates**: Calculation: The Actual cash collected divided by the principal amount that have fallen due to be paid. This is also known as the repayment rate or the recovery rate and is considered the most common indicator.

  Amounts Collected
  Amounts fallen due

- **Arrears Rates**: Calculation: The amount of late payments or overdue amount divided by the total loan amounts/outstanding loan portfolio. This is the second most common indicator.

  Overdue Amounts
  Total loans

- **Portfolio at Risk Rates**: Calculation: The outstanding balance of loans that are not being repaid on time divided by the outstanding balance of total loans. This is the international standard for measuring bank loan deficiency.

  Outstanding balance overdue payment (s)
  Total outstanding balance

INSTITUTIONAL IMAGE AND PHILOSOPHY

Disciplined borrowers are critical for the success of Financial Institutions. This involves the conditioning of existing and potential borrowers behavior promoting a positive mindset to loan repayment. Financial Institutions must uphold an image and philosophy that "**LATE PAYMENTS ARE NOT ACCEPTABLE**".

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MANAGEMENT OF DELINQUENCY

For many years, Financial Institutions have endeavored to detain delinquent customers and risky new prospects. Financial Institutions may devise mechanisms aimed at reducing the risk of loan delinquency.

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CanStock

- Regular Review of lending policies and procedures: The economic environment is dynamic. Financial Institutions are sensitive to economic developments hence regular revision of credit policies and loan procedures is prudent to complement the current economic trend.

- Credit Analysis & Proper Client Selection: Financial Institutions can restrict bad loans by ensuring loans are granted to borrowers who are willing and able to repay and are unlikely to become insolvent. Considerations should be made to the borrowing proposition and subsequent repayment in isolation from other management mechanisms. Borrowers should be screened to assess credit worthiness based on the future and the past. The institution is unlikely to encounter delinquency if the best suited clients are selected and proper credit analysis is done.

- Loan Appraisal: It includes clearly identifying the intended project and the borrower to assist the Financial Institution in assessing the ability of the borrower to utilize the loan effectively.

- Effective Loan Supervision/Monitoring Clients: Financial Institutions should take an active interest in their borrowers and monitor their ability to finance their debt. This includes measures such as effective communication before, during and after loan financing, visiting of ongoing projects and the requesting of interim financial data. Consistent interaction with borrowers enables Financial Institutions to immediately recognize early signs of default and allow for interim measures such as extending payments periods, reappraising the borrower's financial position and shifting interest rates.

- Management Evaluation and Training: The success or failure of the lending system of Financial Institutions largely depends on the efficiency of management. Management must effectively plan, organize and control the lending system and therefore, must possess the qualifications and skills necessary on management of delinquency. Continuous training is required before and after loan disbursement.

- Security/Third Party: This is the Financial Institution's assurance of payments in the event of delinquency. It aids in the consistent movement of the Institution's cash flow as per loan investment returns thus reducing the chance of a slow loan portfolio rotation.

- Flexible Repayments terms: Financial Institutions may have fixed and/or flexible repayment terms. Repayment terms should not be rigid depending on the nature, size, and complexity of the borrowers' payment. Once the loan terms are feasible to the borrowers, it is most likely that repayment deadlines would be met.