FINANCE, BANKING AND INSURANCE

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COMPONENTS OF STABILIZATION MANAGEMENT OF TROUBLED BANKS

The functioning of the banking sector under conditions of uncertainty and turbulence periodically leads to the emergence of serious financial problems in certain banks, which causes concern among supervisory authorities. To maintain the stability and reliability of the banking sector, such banks fall under a special supervisory regime. In Ukraine, they are recognized as problematic banks by the National Bank of Ukraine (NBU) and are obliged, in accordance with the Law of Ukraine "On Banks and Banking Activities", to develop a plan of measures within seven working days to bring their activities into compliance with the requirements of the legislation [1]. To preserve the bank's existence, such a plan, which can be considered a financial stabilization plan, must be successfully implemented within 120 days. Accordingly, from a management point of view, the bank transitions into a stabilization management mode. Its goal is to restore the stable functioning of the problematic (troubled) bank, remove it from the state of being problematic, and prevent the recurrence of problematic situations in the future.

The agents of such management, i.e., individuals who have the right and ability to make decisions regarding the methods and tools for restoring the stable operation of troubled banks, can logically be divided into internal and external ones. The internal agents include shareholders, the bank's supervisory board, which, in accordance with the law, is responsible for approving and monitoring the implementation of plans to maintain capital adequacy and liquidity sufficiency, restore the bank's operations, and finance the bank in crisis situations [1], as well as its management board, which oversees the bank's current activities. Additionally, the possibility of involving a specially created crisis management team, consisting of representatives from various departments and committees of the bank, to stabilize operations is not excluded.

Regarding external agents, the National Bank of Ukraine must be mentioned first and foremost. The NBU's tasks include identifying signs of a bank's distress as early as possible, making a decision to recognize a bank as problematic one, obtaining information from it regarding stabilization measures, and monitoring the progress of these measures. To reduce moral hazard, government intervention should not be predictable when resolving a bank's problems, as regulators believe that shareholders should bear sole responsibility for their investment decisions. If a bank fails to resolve its existing problems within a 120-day period through its own efforts, the NBU makes a decision to classify it as insolvent, followed by reorganization or liquidation with minimal losses to the economy. However, it is important to consider that removing a bank from the market and revoking its license should be regarded as extreme, generally undesirable measures.

External agents should also include investors or strategic partners who, if necessary, can replenish the authorized capital or provide the bank with funds on subordinated debt terms to increase the regulatory capital and meet its adequacy ratios. In addition, external consultants and auditors can play a certain role in the stabilization management of troubled banks, providing advice on the repayment of non-performing loans and debt restructuring, cost optimization, improvement of the risk management, etc.

The planning of bank activity stabilization should be preceded by a deep analysis of its financial condition with the identification of key problems in its activities and their consequences. Such an analysis is carried out using both traditional methods of financial analysis and SWOT analysis, stress testing, expert assessments, and financial modeling. It is important that the analysis is objective, comprehensive, and based on reliable data. Based on the results of the analysis, the factors that led to the deterioration of the bank's financial condition and its acquisition of problematic status are identified. The developed financial recovery plan based on the analysis results should contain specific measures aimed at correcting the situation, with clearly defined quantitative and qualitative indicators that will allow assessing the effectiveness of these measures.

Regarding forecasting quantitative indicators, they should reflect the key aspects of the bank's financial stability. This includes compliance with prudential ratios and rules for the formation of mandatory reserves, increasing the bank's capital, maximizing the balancing of asset and liability terms, increasing the level of liquidity, repaying refinancing loans received from the NBU, improving asset quality, increasing or improving sources of funds, reducing dependence on interbank transactions and ensuring profitability. A component of the plan may be the development of a payment calendar on a monthly basis, which allows monitoring and controlling the bank's cash flows to ensure liquidity and profitability.

In addition, the plan should contain forecasting qualitative indicators that will allow assessing the effectiveness of the bank's management. This includes assessing the effectiveness of governance, improving risk management, reducing administrative costs, and other measures that depend on the specific problems of the bank. Thus, the activity stabilization plan should be comprehensive, cover both quantitative and qualitative aspects of the bank's activity, and contain a clear sequence of actions to achieve the set goals. The capitalization program should include a justification of ways to increase the bank's regulatory capital, in particular, its components, through internal and/or external sources and appropriate forecasting indicators.

It should be mentioned that since 2019, banks in Ukraine, according to the requirements of the NBU [2], have been required to develop recovery plans that reflect a program for implementing a wide range of measures to restore financial strength and viability in the event of shocks. At the international level, the need for banks, especially systemic ones, to create such plans became evident following the global financial and economic crisis to further prevent threats to the stability of the banking sector. The first recovery plans were developed and approved by major American banks in 2012. Their preparation aimed to increase the ability of banks to independently solve most problems, not waste time developing and comparing alternatives to exit the crisis, and ensure the effectiveness of government intervention in the work of banks at early stages of distress. Similar requirements were implemented in the European Union in connection with the adoption of Directive 2014/59/EU, which was abbreviated as BRRD (Bank Recovery and Resolution Directive) [3]. According to it, supervisory authorities must approve recovery plans, prepared by the banks themselves, which define the steps to be taken at the first signs of deterioration of the financial situation.

For Ukrainian banks, the plan should include: several scenarios that respond to specific and systemic risks; a system of indicators for assessing the financial condition using the "traffic light" methodology; reliable recovery measures for each scenario, which primarily address capital outflows and/or liquidity problems; a description of processes that ensure the timely implementation of recovery measures, taking into account stressful situations. Therefore, considering that, according to the NBU's statement, the recovery plan should be developed not only in case of a stressful situation, but also for use in the case of a significant deterioration of the bank's financial condition, and in addition, it a priori takes into account the business model and specifics of the particular bank's activities, we guess that troubled banks should use it as a basis for forming an activity stabilization plan.

During the restoring the stable operation of a troubled bank, constant monitoring of measures' implementation and effectiveness, as well as the achievement of intermediate and final goals, should be carried out. For this purpose, internal reporting systems are used, as well as regular meetings and reports of responsible persons. If necessary, corrective actions are applied in accordance with changes in circumstances and financial indicators, which may include clarification of deadlines for implementation of measures, revision of targets, or development of additional measures. Regular reporting of the crisis headquarters to the bank's management, and, if necessary, to the National Bank, is advisable.

References:

1. Law of Ukraine No. 2121-III "On Banks and Banking" (2000, December). Available at: https://zakon.rada.gov.ua/laws/show/2121-14#Text

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3. Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council Text with EEA relevance. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri= celex%3A320 14L0059