LOAN PRICING AND NEGOTIATION

1/31/2018
10:24 AM

By
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Loan Pricing Consideration

- In pricing loans, total customer-bank relationship has to be looked into. Flexibility is warranted customers using other products also.
- it is good business practice to reward valued customers. A customer who returns to use the bank's products and services clearly represents more than the profit made on a single loan transaction.
- Customer's perspective is important. New small business owners are less concerned with loan pricing than with qualifying for the loan and the size of the monthly payments. Owners of more mature businesses are more likely to be preoccupied with the total cost of a loan.
- Many banks use pricing models that factor in capital adequacy, costs of funding, credit risk, profitability goals, and other assorted variables. Others simply consider the account relationship, current market interest rates, fee income, and what the competition is offering.
- Regulatory guidelines on Base rate needs to be complied.

Interest Rate

Variable vs fixed rates

- Variable-rate loans provide some protection against the risk of unpredictable interest rate changes. This reduces interest rate risk for most banks, because most funding sources are short term.
- However, if interest rates rise too much, a variable-rate loan actually may increase credit risk because the larger resulting loan payment may not fit within the borrower's cash flow.
- Many borrowers will want to "lock in" fixed interest rates when interest rates are relatively low. Of course, this is good for the borrower but may adversely affect the bank later if interest rates rise on the bank's core funding source: deposits.
- With a fixed-rate lending arrangement, a business banker may negotiate a prepayment penalty to compensate for bank losses resulting from the early payment of a loan when interest rates decline.
- To the benefit of the banks, there is hardly any loan with fixed rate neither our variable rates are linked to any indicator. They are determined and revised at bank's discretion.

Interest Rate

The spread

- The net interest rate spread is the difference between the average yield bank receives from loans, along with other interest-accruing activities; and the average rate it pays on deposits and borrowings. The net interest rate spread is a key determinant of a financial institution's profitability (or lack thereof).
- Central Bank has prescribed average spread of 5% for banks. The spread is bsed on yield on loans and treasury and cost of deposits.

Base rate

- The banks can charge the borrower a premium of 2-4 percent over their base rate calculated based on their cost of funds, CRR, SLR, operating expenses and their return on assets.
- Once agreed, the banks cannot change their premium and the rate may change only when the base rate changes.

Interest Rate

Competitive considerations

- The interest rate quoted by competitors is an important consideration. Indeed, competitive factors often have more bearing on the loan pricing than any number of complex formulas, and banks can price aggressively to keep making loans.
- A bank, for example, may adjust the interest rate it charges for loans if a competing lender, not necessarily a bank, offers lower rates for similar lending arrangements.
- Alternatively, a bank may settle for a lower profit or try a strategy that combines a lower interest rate with a lower profitability objective.

Matching Concept

- In order to reduce interest rate risk, a lender should attempt to match the underlying loan price index to the duration of the loan. For short term loans, banks may tie the rates to shorter term indices, but for long term loan rates of long term bods may have to be considered. But as we do not have a practice of indexing, this has to be dealt in differently.

Fees Income

- Fees and other non-interest income are an important source of bank revenue.
- When setting the interest rate, most business bankers consider the sources of other revenue the bank will receive from the customer relationship.
- These types of fee income are attractive to banks because, unlike net interest income, they typically carry no credit risk.

Processing Fees

- Banks often assess a processing fee as compensation for pledging to make a loan at the terms specified during loan approval.
- Banks can not charge processing fees on similar types of loan by differentiating borrowers by more than 25 bp.
- Processing fee to be refunded if the loan is not approved.

Fees Income

Commitment fees

- A commitment fee can be charged on the unused portion of an operating line of credit or a term loan to compensate the bank for committing (setting aside) specific funds for the borrower's use. Some banks call this a "non-use fee."
- Banks can charge commitment fees on working capital loan at the rate as agreed in the loan agreement on the difference of agreed average utilization and actual average utilization, if the latter is less. This fee cannot be charged in advance.
- If the utilization of term loan is less than the approved limit, commitment fee can be charge once in the differential amount.

Fees Income

Prepayment penalties

- A bank can charge a penalty fee to protect the bank against loan prepayment, which most often happens when interest rates decline, the borrower becomes dissatisfied with the bank and seeks a competing loan, or the borrower becomes very liquid.
- If the borrower then elects to prepay the loan, the bank is compensated for having to reinvest the loan proceeds into a different interest rate environment.
- Banks can charge prepayment penalty only as per the terms of the loan agreement.
- If the borrower repays the loan from own income because bank has revised the rate of interest or revised the terms of agreement, no prepayment penalty can be charged.
- If the borrower repays the loan from because the bank has changed the terms of the loan unilaterally, no prepayment penalty can be charged

Loan Negotiation Process

- Negotiation is the process of two or more people attempting to reach a mutually acceptable agreement.
- The negotiation process begins during the initial business development calls and continues throughout the commercial lending process.
- A business banker, as the representative of the bank and as a person who negotiates directly with the borrower, must keep in mind the goals and needs of both the bank and the borrower. During discussions over the terms and conditions of a loan, this approach is wise.
- However, because of the 'agency problem' at times the negotiation may appear to be biased in favor of the borrower which should be avoided to reach a balance.

Loan Negotiation Process

Borrower's perspective

- size of the loan, the financial strength of the business, and the experience of the managers determine the borrower's perspective.
- A borrower who has negotiated loans many times will have a different perspective from a borrower who is obtaining a loan for the first time.
- A new or growing business generally negotiates fewer points than a mature (seasoned) business.
- Borrowers who have superior financial strength usually are more vigorous negotiators. Such borrowers enter a negotiation with the perspective that they have many financing alternatives.
- Each customer is different, and the negotiating approach taken by a business banker must be appropriate for the individual customer.
- Regardless of whether the customer's attitude is one of cooperation or antagonism, the lender must conduct all negotiations professionally.

Loan Negotiation Process

- **Loan Approval Authority**
- To safeguard the bank's depositor and shareholder interests further, most banks maintain loan approval authorities. The authorities are given based on the experience and ability of each person.
- A business banker's individual loan authority is comparatively small, if any at all and responsibility for most credits is limited to assembling the loan package and making an approval recommendation. The approval decision is left to a more senior officer or a committee.
- Differentiating between the loan development and approval functions ensures more complete objectivity.
- This centralized approach can be less efficient, in terms of customer response times, and less ownership of the process by the front line lender.
- The alternative, Decentralized approach, is considered more subjective, leading occasionally to poor credit decisions and inconsistent lending practices.

Loan Negotiation Process

Setting terms and conditions

- A business bankers should differentiate between necessary terms (non-negotiable) and nice terms (negotiable). For a loan to be approved, the borrower must agree to certain necessary conditions. A common example is collateral issue, where the bank has little room for concession.
- Nice terms can vary from type of interest rate (variable or fixed), timing of payments, to minor issues regarding collateral.
- A lower interest rate is nice for the borrower, but if additional concessions are requested, the business banker may not be able to change the interest rate.
- Individual terms and conditions should be considered within the context of the entire agreement, and any concessions made are subject to change, depending on further or additional changes.

Loan Negotiation Process

Minimum acceptable terms

- Once necessary terms are identified, the business banker then decides on the position to take on negotiable, nice terms. A good strategy is to enter the negotiations with two positions in mind– a "want" position and a "will accept" position.
- The "will accept" position represents minimum acceptable conditions and ensures that the business banker does not leave the bargaining table having conceded too much on the negotiable, nice terms.

Loan Negotiation Process

Minimum acceptable terms

Example

If expecting to negotiate and possibly compromise, a business banker may state at the start of negotiation that the bank "wants" a total value of collateral equal to 133 percent of the loan balance. (The result, from the banker's perspective, is a 75 percent loan-to-value ratio or LTV). This provides some bargaining latitude on other issues as well. For example, in exchange for agreeing to decrease the collateral value from the stated 133 percent to 125 percent (for a riskier, 80 percent LTV), the business banker could insist that the risk on the loan be reduced by a shorter amortization period for the loan payments, or some other concession. However, a business banker usually should not grant a concession without receiving something in return. Otherwise, the lender is merely conceding and not negotiating.

Loan Negotiation Process

Minimum acceptable terms

- The "will accept" position represents minimum acceptable conditions and ensures that the business banker does not leave the bargaining table having conceded too much on the negotiable, nice terms. Unless there are other considerations, the 80 percent LTV represents the "will accept" position.
- Minimum acceptable position means just that—the 80 percent LTV is the minimum acceptable position for the lender, and likely reflects how the loan will be approved.
- However, the business banker should not allow the minimum position to become the only goal.
- When the customer does not accept other concessions to lower risk or increase return, the 75 percent LTV is a better collateral objective.
- It becomes less of a negotiable, nice term and more of a non-negotiable, necessary term.

Business Banker's Role in Negotiation

Opening the Negotiation

- Prior to the meeting the discussion agenda must be set. You should be ready with the list of non-negotiable and negotiable items.
- A proper introduction with name, title and hand shake sets the stage for a professional, courteous dialogue.
- In most cases, through business development calls the "get-acquainted process" has already been achieved. Even so, individual meetings with the customer should always have some sort of "warm-up" with greetings and even casual conversations before getting down to business.

Business Banker's Role in Negotiation

Presenting the proposal, listening to counter-proposal

- Using the agenda, begin the negotiation by presenting the bank's specific proposal. Alternative or minimum acceptable terms, of course, are held in reserve until needed.
- Customers may counter the bank's proposal with specific conditions of their own. Take notes about whether the customer's conditions are acceptable, negotiable, or nonnegotiable, but without responding to the conditions directly. Waiting for the customer's counterproposal serves the following purposes:
  - It defers possible discussion, and perhaps conflict, to a time when the terms are ready to be negotiated. Interrupting a customer with a "There's no way I'll agree to that!" could sidetrack the negotiating process quickly
  - It helps with an orderly presentation of terms and conditions to ensure that no last-minute demands will surface just as the negotiation is about to be concluded
  - It can provide more insight into the customer's bargaining stance, for example, issues that the customer considers to be of primary and secondary importance

Business Banker's Role in Negotiation

Reaching agreement

- At this point in the negotiation, the business banker should be fully aware of the customer's objectives and position.
- Occasionally, fundamental differences, unlikely to be resolved even through a protracted negotiation, may evolve. In such cases, it is best to close with the understanding that perhaps the bank can be of assistance sometime in the future.
- Most often, however, grounds do exist for a successful negotiation. If so, the next step is to resolve conflicts and come to a mutually satisfactory agreement.

Business Banker's Role in Negotiation

Handling conflict

- Coming to terms on key issues is not always a smooth process.
- Conflict may be part of the negotiating process, and the ability to handle it is frequently the difference between achieving a good lending arrangement or no arrangement at all.
- A customer who proposes a series of unacceptable demands should be dealt with in a calm and reasonable manner. Do not react emotionally and lose control of the situation.
- Some customers are difficult and may like the confrontations that arise, hoping to improve their position and extract concessions.
- By recognizing and preparing for such situations, avoid letting conflicts undermine negotiations and focus on arriving at a lending arrangement that fulfills the bank's objectives.

Business Banker's Role in Negotiation

The art of compromise

- By definition, negotiation involves compromise to reach agreement.
- Knowing when and how much to compromise on issues is where most of the art of negotiation lies. There are times to take a hard-line approach and there are times to demonstrate flexibility.
- It is important to avoid rejecting outright any alternatives offered by the customer. Even basically unacceptable suggestions should be considered and treated as a step in the right direction. Try to avoid an outright rejection, which may encourage the customer to do the same, thus ending compromises.
- Do not make concessions too readily. Withhold full-fledged acceptance of a customer's suggestion until all alternatives are on the table.
- In return for agreeing to a proposal offered by the customer, obtain concessions on other issues. Compromise does not mean equal give-and-take on all issues, nor does it mean all concessions are one-sided.

Customer Negotiating Strategies

Misleading

- There is always the chance that a customer will be misleading or less than forthright. For example, in an attempt to lower the pricing of a loan, a customer may falsely state that another bank has made a better offer.
- You have little defense against such misleading comments. Your only response may be to simply ask about the competitor and the competitor's terms.
- At the time of negotiation, however, the only solution is to know the acceptable terms and to stand by those terms.

Take it or leave it

- To apply pressure to close a deal, sometimes business customers will issue a take-it-or-leave-it challenge.
- Such a posture may grow out of a sense that the negotiation is not going well, or it could be an attempt to employ leverage.
- In either case, the lender may propose alternative terms that the customer may find acceptable. Otherwise, the decision may well be "take it" or "leave it."

Customer Negotiating Strategies

Threats

- On an important issue, a customer may resort to threats, either implied or explicit.
- Rather than honestly negotiate the collateral terms for a loan, a customer will hint that unless the desired terms are met, a call will be made to a member of the bank's board of directors.
- Dispensing with such threats is difficult, particularly if the customer's business is valued or the individual has a close relationship with a director.
- Whenever there is an extensive prior relationship with a bank, the customer has considerable leverage, which may be used to exert pressure.
- A threat may be a frustrated response to a failure of the customer to obtain what was considered a necessary, non-negotiable, concession from the bank.
- Ignore the threat, reaffirm that the loan must be negotiated on its merits alone, and try once again to reach a compromise on the issue in conflict, perhaps by offering a fresh proposal.

Customer Negotiating Strategies

Escalating demands

- To extract one last concession from the business banker, a customer might, at the last minute, change a point that had been agreed to earlier by both parties.
- Just as the negotiation is about to close and a borrowing arrangement finalized, the customer may inject, "It just occurred to me that I have already pledged that piece of equipment as collateral. That requirement will have to be dropped."
- This tactic obviously is designed to play on the business banker's fear that the negotiations will collapse unless one final concession is made.
- When this occurs, the best response is to remind the customer that both parties agreed on this issue earlier in the negotiation.

Customer Negotiating Strategies

Bad-faith negotiation

- When a negotiation begins, it is reasonable to assume that the customer is as eager as the business banker to come to an agreement. Unfortunately, this is not always the case.
- Occasionally, a customer, with no intention of seeking a lending arrangement, may play one bank against another to come up with the best deal.
- A solution to bad-faith negotiators is to avoid getting embroiled in a lengthy bargaining session.
- Once it is apparent that there is no give and take, even on minor points, end the session and schedule another.
- If serious about negotiating, chances are the customer will return to the bargaining table in the near future. If not, the business banker is spared the expense of becoming entangled in a fruitless negotiation.

Customer Negotiating Strategies

- ***Personality conflicts***
- Occasionally a customer will take a personal dislike to a business banker. The customer may object to dealing with a young or inexperienced lender or, there may be a conflict in style or personality—a light and enthusiastic business banker versus a serious and conservative customer, for example.
- Responsibility for smoothing over personal differences rests with you . Even when treated in a less than respectful manner, assume a thoroughly professional attitude and set aside emotions.

The most effective approach to a difficult customer is to avoid becoming a hard negotiator that refuses concessions on any issue. On the other hand, do not be overwhelmed and surrender on nonnegotiable issues. A customer may assume an aggressive stance merely as a ploy to increase leverage..

Closing the Negotiation

- Negotiations cannot be closed until every important issue is resolved. As the negotiation proceeds, it is a good idea to stop periodically and review the overall position of both lender and These reviews serve the following purposes:
  - It shows the progress made so far, thus imparting a positive atmosphere to the negotiation
  - It clarifies the situation, which may become confused in the different offers and counteroffers
  - It helps maintain control of the negotiation and reaffirms the perception of the business banker as the leader of the proceedings
- If the negotiation appears stalled, stop the discussions entirely, and reschedule for another time. A change in time or location may “clear the air” and get discussions rolling again. It also gives the business banker an opportunity to consult with colleagues to fetch some fresh, alternative approaches.
- When agreement on the major issues is sensed, the business banker moves to close the negotiation.
- Summarize the key agreements of both the customer and the bank and say that it appears that both parties have struck a good deal.

Thank you

PROBLEM LOANS

1/31/2018
10:24 AM

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Problem Loans

Problem Loans

- The point of the picture is, of course, that to achieve such a record, the banker must have turned down many good loans over the years.
- Although problem loans are costly to the bank and should be minimized, a balance must be struck between careful, prudent lending practices and making full use of the bank's assets.
- Both lax and unduly conservative lending practices are detrimental to bank profitability.
- Problem loans are an inevitable consequence of lending. Any time a loan is made, unforeseen events can make it difficult for the borrower to live up to the terms of the loan deed and other documents.
- The answer to problem loans is not to stop making loans or to be excessively strict in making decisions. A capable business banker can keep the number of problem loans at an acceptable level as bad loans do not happen by chance.

Cost of Problem Loans

Damaged reputation

- Banking is built on the foundation of trust.
- A bank can attract the funding it needs for loans and other investments only if its depositors and investors have confidence in the bank's ability to handle their money prudently.
- As a bank grows its loan portfolio, a few problem loans can be expected. An excessive number, however, damages the bank's reputation with its customers and investors.
- Once that happens, profitability declines, capital is difficult or more expensive to attract, and growth of the bank is hindered.
- When problem loans arise out of a push for growth rather than credit quality, a bank may develop a reputation for granting too much "easy credit."
- This growth strategy invites more high-risk borrowers and, consequently, loan problems compound.

Cost of Problem Loans

Increased administrative costs

- A problem loan, which may take several years to resolve, demands far more attention from bank personnel.
- You need to devote more time meeting with the borrower and monitoring the loan.
- Other bank divisions, such as recovery and audit, spend more time monitoring problem loans.
- The unproductive time spent monitoring a problem loan serves merely to protect the bank's assets. It does not generate additional revenue.
- Furthermore, additional costs will accrue if outside appraisers, consultants, and other specialists need to be hired.

Cost of Problem Loans

Lower employee morale

- When a bank experiences an excessive number of problem loans or charge-offs, employee morale usually suffers.
- An unprofitable bank cannot reward its employees with salary increases and bonuses.
- If the loan situation is particularly bad, hiring freezes or layoffs may occur. As a result, the best business bankers and other key personnel may resign.
- The bank then either trains new employees or pays a premium to attract people as qualified as those who left.

Cost of Problem Loans

Increased regulatory expenses

- A bank with an unusually high number of problem loans normally will find itself subject to increased oversight and control from Nepal Rastra Bank.
- Special reports may have to be filed with NRB, with the bank paying the extra cost to prepare the reports.
- In some instances, the bank has to establish special loan committees and institute more stringent loan approval processes. Loan approvals may be centralized at Board level only by the NRB which delays the process.
- When regulatory controls are imposed on a bank, the increased personnel commitment and added delays in getting required approvals may cause loan opportunities to be lost and bank profitability to be reduced.

Cost of Problem Loans

Increased legal expenses

- A problem loan eventually may have to be resolved in a protracted lawsuit. If so, by the time litigation is over and a settlement rendered, the attorney fees and court costs may reduce the bank's debt recovery substantially.
- For any action the bank has taken or is preparing to take to recover a bad loan, the borrower can go to the court requesting to stop the process with various charges to the bank like not giving the proper information, harassment, misguidance, interference, threat etc.

Causes of Problem Loans

Business banker causes of problem loans

Although it is difficult to consider that a professional business banker could cause a loan default, the following business banker actions can undermine a loan:

- Poor business development calls
- Inadequate financial analysis
- Improper loan structuring
- Poor support and documentation
- Lack of proper monitoring
- Inadequate analysis of guarantors

Causes of Problem Loans

Bank causes of problem loans

A bank's management sometimes may contribute unknowingly to an increase in past due and non-accruing loans on the balance sheet. Following bank strategies can be the cause of problem loans

- Growth at the expense of quality
- Originating loans to industries the bank does not understand
- Lending outside the market

Borrower causes of problem loans

In most cases, the borrower is the cause of business difficulties and the resulting problem loan.

- Many times a problem loan is the result of poor business practices, including lack of **management depth, poor product or service, and poor financial controls.**
- A borrower that cannot describe its business problems, other than stating that it has a cash flow problem, probably does not fully comprehend its business problems. Inadequate cash flow is a symptom of other problems, but borrowers often blame it as the cause.

Causes of Problem Loans

Adverse External Developments

- **Environmental factors** causing natural disasters such as fire, floods, landslides etc.
- **Economic factors** such as economic downturns, changes in tax laws, and changes in interest rates
- **Competitive factors** such as emergence of a strong competitor
- **Regulatory factors** such as government increasing minimum wage significantly effects a labor intensive business having a significant number of low-paying positions.
- **Technological factors** such as competitor introducing a more advanced product can adversely affect the financial fortunes of a high-tech company

Steps to resolve problem loans

- Although a bank may avoid many problem loans by promptly identifying various early warning signals and correcting difficulties, some loans reach the point where a workout plan or collection effort is unavoidable.
- In attempting to resolve a problem loan, a business banker's primary objective is, of course, to ensure repayment of the debt.
- Ideally, this is accomplished by working with the borrower to restore the business to a sound and profitable operating position.
- If that effort fails or the company's problems are too advanced, then the bank, to protect its position, either demands payment from the borrower and any guarantors of the debt, or liquidates the collateral.
- Following steps need to be followed.

Steps to resolve problem loans

Re-evaluate the borrower

- Until a borrower has been tested by adversity, it is difficult to measure a borrower's character accurately. When a business weakens, a business banker reevaluates the borrower in light of the new circumstances.
- Questions arise, such as "Is the borrower willing to recognize the problem and work with the bank to solve it?" A workout plan is fruitless if borrower does not cooperate.
- Another key question is, "Can the management that led the business into financial trouble solve the company's problems?"
- In previous adversity, has the borrower exhibited any signs of uncooperative behavior? If so, the first step is to reevaluate how the borrower may react to this new situation.

Steps to resolve problem loans

Assess the situation

- Assessing the situation involves evaluating the bank's and borrower's strengths and weaknesses. The results of this evaluation are used to determine a course of action.
- A business banker who discovers that the value of the bank's collateral has declined significantly and essentially represents no security for the loan may decide to make a strong effort to work with the borrower, perhaps to the extent of lending additional money in exchange for obtaining other security for the loan.
- If, on the other hand, the bank controls the collateral and can sell it, net of costs, for a sum that covers the remaining loan balance, the business banker may choose this option.
  - Reevaluate bank's situation
  - Review documentation
  - Evaluate collateral situation
  - Monitor borrower's bank accounts
  - Consult with outside resources

Steps to resolve problem loans

Initial meeting with the borrower

- This initial meeting helps to define the best course of action: to continue working with the borrower, ask for repayment, or move to liquidate the collateral.
- During the initial meeting, the business banker should discuss the problem, explore available alternatives to solve the problem, and establish acceptable actions. The parties also outline interim steps to resolve the problem.
- The primary goal of the initial meeting is to get the borrower to admit there is a problem. This is not as easy as it may seem.
- This way of thinking usually has regrettable consequences. The "nonexistent" problem loan steadily becomes more of a problem until it cannot be ignored. By then, the business banker and borrower can do little to salvage the situation.
- Regardless of whether the bank ultimately decides to continue working with the borrower or to liquidate, a cooperative effort is important.
- The lender needs to know how to work with the borrower so the bank's objective of debt repayment is realized. Because borrowers may be facing the possible "death" of the business, their reaction may run the gamut of denial, anger, bargaining, depression, and finally acceptance.

Steps to resolve problem loans

Borrower's reactions

Denial

- Initially, the borrower may refuse to accept that a problem exists; or, if acknowledged, the borrower may blame the problem on others, including the lender.
- A good approach to these protests is to listen patiently to the borrower's reasons and then carefully or selectively refute some of them if there is documentary evidence on hand.
- Regardless of the causes of the problem, the business banker should explain to the borrower that he or she has the responsibility for resolving the problem. It is in the best interest of the business for the borrower to work at changing those things that are controllable.

Anger

- The second stage, often anger, is expressed by hostile, blaming, or belligerent behavior.
- When confronted by an angry borrower, a business banker must resist responding in kind. Instead, empathy will help the borrower through this stage, which eventually will subside as the situation is accepted.
- A business banker should never meet alone with a problem borrower, much less an angry one. Another bank officer should be present as a witness at any meeting with the borrower, to help the conversation and note any agreements or disagreements.

Steps to resolve problem loans

Bargaining

- Bargaining generally follows anger. The borrower begins to realize that something must be done, but remains reluctant to make major changes.
- The borrower may simply try to postpone inevitable, difficult decisions or suggest unrealistic proposals to rectify the situation.
- A business banker, however, should direct the borrower toward accepting realistic solutions. While pointing out issues in the borrower's proposals, the business banker remains constructive and encouraging.

Depression

- When the borrower finally realizes a problem exists and strong measures are needed, depression may set in. Rather than downplay the problem, the borrower may swing to the opposite extreme and view the situation as hopeless.
- A perceived loss of status and respect often exacerbates the depression.
- A business banker again should respond with empathy, assuring the borrower that the situation is not unique. Many businesses have had similar problems and were able to resolve them.

Steps to resolve problem loans

Acceptance

- Acceptance, the final stage, is accompanied by a sense of renewed energy and willingness to address the problem.
- This is the best time to work with the borrower and move toward a solution.
- The borrower may not agree necessarily with all of the bank's proposals, but the reasoning process is now more rational.

Problem Loans Solutions

Rehabilitation

- One alternative in dealing with a problem loan is to continue working with the borrower, hoping to resolve the problem over time.
- Obviously, certain elements must be present. The business must have adequate physical and personnel resources, a market must exist for its products and services, and sufficient capital must be available to finance operations.
- Another essential ingredient is a spirit of voluntary cooperation between the bank and the borrower. Both parties must work together to establish a framework to repay the loan.
- If the borrower's objective in a loan workout is just to buy some time, then continuing with the borrower is obviously not in the bank's best interests.
- At a minimum, the initial meeting should provide both a timeline and a framework for a plan to resolve the problem and monitor its effects if further action is needed.
- The borrower and business banker also may want to restructure the loan or advance additional funds.

Problem Loans Solutions

Liquidation

- Liquidation is a viable approach to a problem loan when the lender determines a loss is imminent, the borrower is unwilling to cooperate, or the bank wishes to limit the time and resources it otherwise would commit in working with the borrower.
- In essence, liquidation is a quick route to collecting at least some of the debt and ending the bank's involvement with a problem loan.
- In essence, liquidation is a quick route to collecting at least some of the debt and ending the bank's involvement with a problem loan.
- Before proceeding to liquidate collateral, a business banker considers the bank's rights to collateral, the borrower's cooperation, and the collateral's value and marketability.