

NON-PERFORMING LOAN RECOVERY: THE CASE OF MONGOLIA

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Abstract:

In this study, the activities related to the repayment of non-performing loans were considered by “Savings Bank” JSC. According to the survey, it takes an average of 4.2 years to repay non-performing loans, and repayment rate is on average 83 percent. Although the repayment rate of loans was high in the first years of the receiver's appointment, the repayment rate has been declining over time. However, the amount of repayments out-of-court was relatively small compared to the amount of that settled in courts, but in terms of time, it took 1.3 years more.

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1 INTRODUCTION

Deteriorating bank lending quality is one of the main factors increasing the vulnerability of the financial sector. For example, examples of international banking and financial crises clearly show that the rapid growth of non-performing loans (NPLs) can adversely affect banks' operations and lead to financial instability (Demirgüç - Kunt and Detragiache, 1998; González - Hermosillo, 1999; Hoggarth et al., 2004; Laeven, 2016). Therefore, strengthening the credit risk management of the banking sector, improving the methods and practices for effective repayment of non-performing loans, and taking other necessary measures are important to reduce the cost of credit risk (Dimitrios, 2016).

Today, 14 commercial banks, 3 receivers (Zoos Bank, Savings Bank, Capital Bank) and 538 non-bank financial institutions (NBFIs) are engaged in non-performing assets (loans and receivables), in the financial sector of Mongolia. However, in Mongolia, there are no previous reports, studies, analytical methods, and experience on non-performing or bad loans.

This shows that since Mongolia's transition to a two-tier banking system, legislators, policymakers, investors, and financial institutions have been without clear research and public information on the methods, experience, timing, and efficiency of non-performing loans repayment. For example, Mongolian legislators, policymakers, and foreign and domestic investors often have asked the two questions, "What is the average repayment period for non-performing loans?"; "What is the average repayment rate for non-performing loans?".

In addition, this type of international research has yielded different results depending on the country's banking, financial, and economic characteristics in terms of non-performing loan repayment methods, practices, policies, controls, and regulations (Woo, 2000, Shih, 2004, Xu, 2005, Matoušek and Sergi, 2005).

Therefore, this study is the first study conducted in Mongolia to clarify the above two questions and find answers to other questions. In addition to laying the groundwork for further research and analysis, their methods and practices needed to identify, select and develop cost-effective methods and solutions for lowering interest rates and non-performing assets in the country, this work will also reduce interest rates and reduce non-performing assets. It is important to support the search for optimal solutions.

The survey included information on a total of 660 (non-performing) assets (loans) settled by the receiver of Savings Bank JSC from July 22, 2013 to December 31, 2019 used as a case study.

The two main questions that need to be answered as a result of this study, as well as the questions that need to be clarified and their estimates, are presented in the appendix.

1.1 Assets in the balance of the receiver of the Bank in Savings Bank JSC:

On July 22, 2013, the Bank of Mongolia appointed the receiver to the Savings Bank JSC and decided to liquidate Savings Bank JSC as a legal entity.

Savings Bank was an influential bank that accounted for 15.9 percent of the total depositors in the banking system at the time of the appointment. The difference of 119.9 billion MNT will be paid to the Deposit Insurance Corporation. Accordingly, 'bad assets' or a total of MNT 191.5 billion in assets and MNT 119.9 billion in payables to others remained in the balance of the Savings Bank.

In addition to loans and receivables, the Savings Bank's non-performing assets include non-performing assets transferred from Mongol Post Bank to the Savings Bank in March 2010.

1.2 Survey data collection:

In the study, the NPLs of Mongol Post Bank transferred to the Savings Bank were identified as “promissory notes” in terms of assets type, and the assets of the Savings Bank were differentiated and compared. Assets marked “loans” are NPLs belonging to the Savings Bank.

Among the total assets of the Savings Bank, the loan profiles of the Mongol Post Bank were incomplete, the loan interests were collected manually, the registrations were offline, the statute of limitations for claiming the loan agreement expired before the receiver was appointed, and the bank's registration software changed after the loans were issued. The most common of these problems were disruption of the lending transaction due to the change, inaccessibility, and discrepancies in the registration due to incorrect entry of the borrower's personal information in the computer program. Therefore, it should be noted that it was also the most difficult to collect research data.

1.3 About the borrower's loan repayment process

In accordance with the Banking Law, the receiver sells the above-mentioned non-performing assets and transfers the assets transferred to the ownership of the Savings Bank based on the loan liabilities, including the Deposit Insurance Corporation, the Bank of Mongolia, the State Bank and the Tax Authority. Regularly reports to the Bank of Mongolia on the progress, results, and risks of its operations.

Since August 2017, the receiver has shifted its NPLs settlement to a “teamwork” system and operates within the framework of the following principles. These include:

- Repay loans and receivables in the shortest possible time and with the highest possible amount,
- In each case of loans and receivables, to take legal action “to the point”,
- Take immediate measures to prevent the value of assets transferred as collateral for loans and receivables from depreciation, depreciation, protection of value at its current level and not to reduce its value.

Loans and receivables are a complex set of measures that require a lot of work to be done at low cost, depending on the nature of the bank being liquidated.

1.4 About the selected indicators for collecting closed loan information:

In this study, we analyzed a total of 660 closed loans based on the borrower's name, registration number, customer registration, and associated account number for each of the 38 indicators and identified (detailed) for each indicator.

It should be noted that not all of the issues identified for each of these indicators are covered in this report, as the purpose of identifying and selecting the 38 indicators mentioned above is not only to write this research report but also to further study asset management activities and develop activities in this area.

These indicators included in this report were selected based on the best possible identification of the questions posed in this report, the best possible answers, and the ranking of the most influential factors. For example, determining when a loan was first issued, when it was

last repaid when it was classified as a non-performing loan, and when it went to court are important for accurately calculating the statute of limitations for claiming a loan and claiming and repaying the loan.

Therefore, in addition to the above 38 indicators and other necessary information related to the above period, it was analyzed by specific sub-sections and collected for each indicator and sub-section.

1.5 Determining the date of transfer to non-performing loans:

Pursuant to Article 2.1.1 of the “Regulation on Asset Classification, Establishment and Disbursement of Asset Risk Fund” approved by the joint order of the Governor of the Bank of Mongolia and the Minister of Finance No. A-155,134 dated June 10, 2019, classified into categories. These three categories can be summarized in terms of asset maturities:

	2019.06.10 (A-155\134)		2010.08.11 (475/182)	
№	Asset classification	By payment overdue days	Asset classification	By payment overdue days
1	Performing	≤ 15; ≤ 30	Performing	
2	Special mention	≤ 90	Special mention	≤ 90
3	Non-Performing of which:		Non-Performing of which:	
3.1	Substandard	91 – 180	Substandard	91 – 180
3.2	Doubtful	181 – 360	Doubtful	181 – 360
3.3	Loss	≥ 361	Loss	≥ 361

Although, as mentioned above, “Non-performing” and “Loss” assets are different concepts, they are often referred to as “Bad assets” by the public. In addition, there was no need to classify the Savings Bank’s assets as “Performing” or “Doubtful” as they were all classified as “Loss”. However, in this study, care was taken to determine exactly when each asset was classified as Loss. For some assets, this was difficult to determine, so each asset was considered a non-performing loan from the time it was classified as a non-performing asset. Therefore, for research purposes, the “Non-performing” or “Loss” assets (loans and receivables) mentioned in this study can be understood together as ‘Non-performing assets’ or ‘Non-performing loans’.

In most cases, the date on which the loan was transferred to the non-performing category and the loan and interest balances for that day were used in the calculation.

1.6 Difficulties in collecting information on closed loans and solutions:

There were some difficulties in collecting information on the total of 660 closed loans for each of the above indicators and categories. For example, many problems have arisen, such as software discrepancies, incomplete loan profiles, misspellings of the borrower's name and registration number, which cannot be found in the program, and have been resolved in an appropriate manner. Here are some of them:

- (i) When classifying total loans, it was difficult to determine the amount and timing of the initial disbursement due to differences in the software used to disburse the loan. For example, loans disbursed before 2008 were often recorded offline or manually, without any software, so the amount of the loan was determined based on the amount of the loan, and the date of the loan agreement was calculated as the date of disbursement. Prior to 2008, the Savings Bank and Mongol Post Bank registered credit card rights in another

program, which is now available on only one computer at the State Bank. When the program applied to the State Bank for borrower information, it was not complete and it took a lot of time. Therefore, for some loans, the Grape bank program determines the amount for which the loan was first registered, the date the loan was first issued, and the loan amount.

- (ii) Although the original date of issue is calculated from the date of the loan transaction, as mentioned above, it was not possible to determine the exact amount of the original loan for the loan granted at the time of offline registration and card authorization. The bank determines the amount of loan disbursed and the date of disbursement based on the balance installed in the program.
- (iii) To determine the amount of non-performing loans and the transition period to non-performing loans, 80 percent of the total loans have interest accrued, 397 percent have accrued interest offline, no information on how much has been accrued and how much has been repaid. Suddenly the loan interest rate and the increased interest account were opened and the accumulated balance as of the opening date of the account was installed. Therefore, it was not possible to know the loan interest rate and accrued interest balance at the time of transferring these loans to non-performing loans, so the loan interest rate and accrued interest balance were calculated as 0 (zero) MNT.
- (iv) Some borrowers have a long credit history or have taken out multiple loans at the same time, making it difficult to determine the amount of non-performing loans, total loans disbursed, and loans repaid. An example of this is a pension loan, in which a borrower borrows more than once, and the loan is accrued over a long period of time, depending on the size of the pension and the interest rate, such as a monthly loan. In this case, the date of the first loan is determined by the date of the first loan, and the loan amount is calculated as the total loan amount.
- (v) For loans repaid in USD, it was not possible to convert the loan into MNT at the current exchange rate due to a lack of information on each repayment date. The loan is translated at the average exchange rate issued by the Bank of Mongolia for the year in which the loan was transferred to the non-performing category.

2 GENERAL INFORMATION

Between 2013 and 2019, the receiver of the Savings Bank fully resolved 660 non-performing assets or loans with a total outstanding loan of MNT 21.0 billion. Of this, 54% or 11.4 billion MNT was paid in the performing category, and the remaining 46% or 9.6 billion MNT in the non-performing category.

As of the end of 2019, MNT 8.2 billion of the non-performing loans of MNT 9.6 billion have been repaid, and the repayment of non-performing loans is 86%. During this period, the amount of loans increased by 1.08 times and 22.6 billion MNT was repaid. Of the 660 non-performing assets surveyed, the lowest value is MNT 39,000 and the highest value is MNT 4 billion.

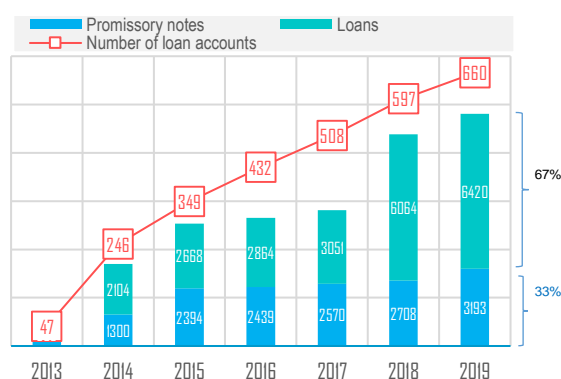
Figure 1: Total loans and non-performing loans (2013-2019)

Year	Total loans	Loans	NPLs	Ratio of NPLs to total loans	Amount of NPLs repaid	Repayment rate of NPLs	Total repayment
2013	1,643.0	468.2	1,174.8	72%	932.7	79%	1,568.8
2014	8,716.5	6,487.4	2,229.1	26%	1,637.8	73%	8,777.4
2015	2,865.6	1,206.6	1,659.0	58%	1,605.2	97%	3,896.7
2016	504.1	264.8	239.3	47%	187.4	78%	596.9
2017	506.3	187.6	318.7	63%	214.1	67%	536.8
2018	5,669.7	2,518.6	3,151.0	56%	3,081.8	98%	6,255.7
2019	1,132.9	291.6	841.3	74%	583.0	69%	1,016.2
Total	21,038.2	11,424.9	9,613.2	46%	8,242.1	86%	22,648.4

Source: Bank of Mongolia

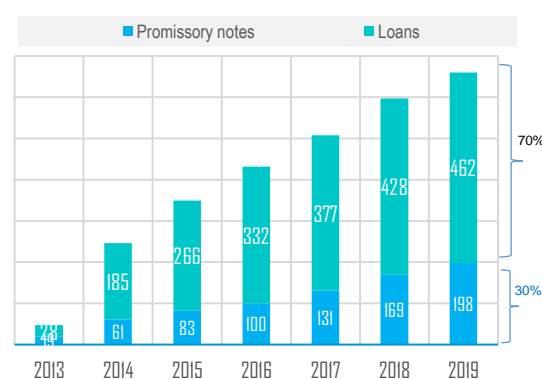
In terms of non-performing loans in terms of assets type, 67% or MNT 6,420 million of the MNT 8,242 million are loans, and 33% or MNT 3,193 million are long-term promissory notes. In terms of total non-performing assets, 70% or 462 are loans and 30% or 198 are promissory notes.

Figure 2: Composition of NPLs, by assets category (in stock)



Source: Bank of Mongolia

Figure 3: Total number of promissory notes and loans (in stock)

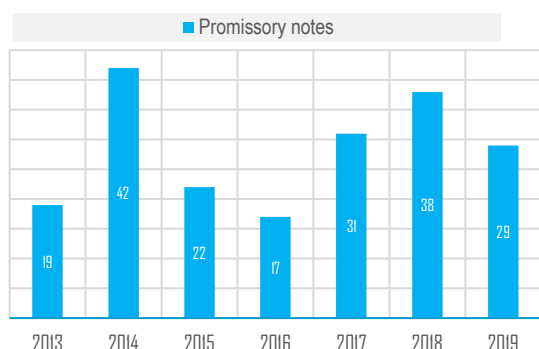


Source: Bank of Mongolia

Between 2013 and 2019, the average annual loan repayment rate was 66 and the number of promissory note payments was 28. The table above shows that the number of loan repayments has been declining year by year, while the number of promissory note payments has been higher than the average in recent years. One of the reasons for the increase in the number of promissory note payments was the transfer of NPLs recovery activities to a 'teamwork' system. This is because prior to August 2017, the Bank's receivership process traditionally mandated the settlement of many more loans per individual or a NPL collector, rather than 'teamwork'. Because it involves a large number of loans per person, there was a tendency to 'sample' from the

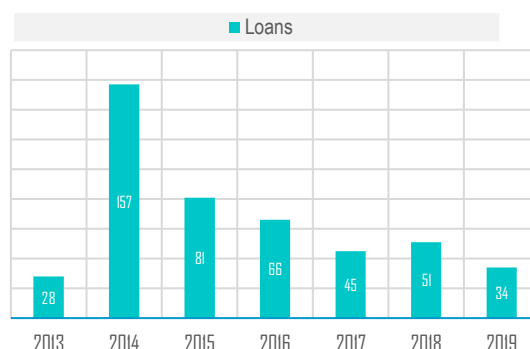
individual due to criteria such as the fastest, most reliable, least efficient, and highest amount. As a result, the most active and least repayable loans and receivables were delayed.

Figure 4: Change in number of promissory notes repaid



Source: Bank of Mongolia

Figure 5: Change in number of loans repaid

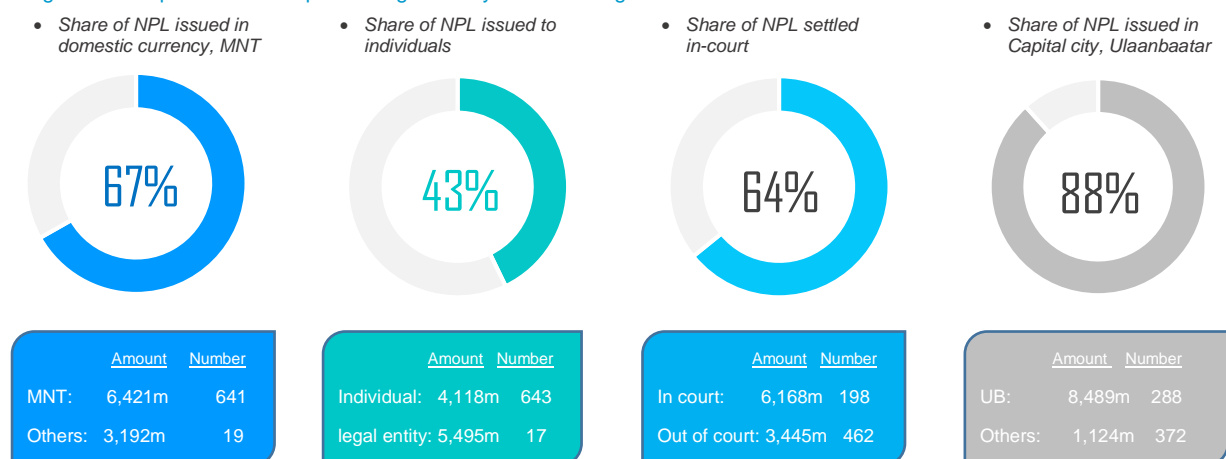


Source: Bank of Mongolia

This is due to the fact that the number of loans that can be repaid is decreasing year by year, on the other hand, it is more difficult to repay, the borrower is reluctant to repay, and there is little opportunity to go to court (no personal need, the expired statute of limitations, etc.).

In addition, the structure of non-performing assets is classified as (i) the currency in which they are issued, (ii) the individual or legal entity, (iii) the geographical location, and (iv) the judicial and non-judicial settlement, as shown in Figure 4.

Figure 6: Composition of non-performing loans by various categories

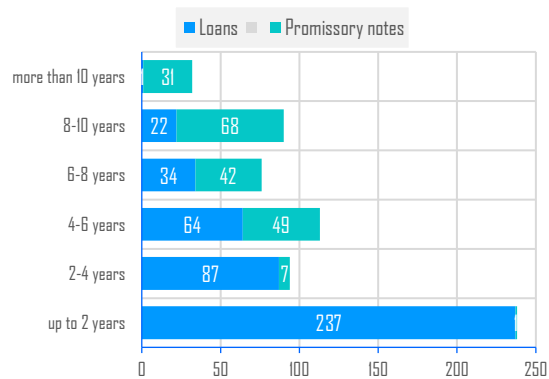


- 67% of total non-performing loans are in MNT.
- 43% of non-performing loans are loans to individuals and 57% are loans to legal entities.
- 64% of loans were settled in court, while 36% were settled out of court.
- Loans in Ulaanbaatar accounted for 88% of total non-performing loans.

2.1 Non-performing loan repayment period

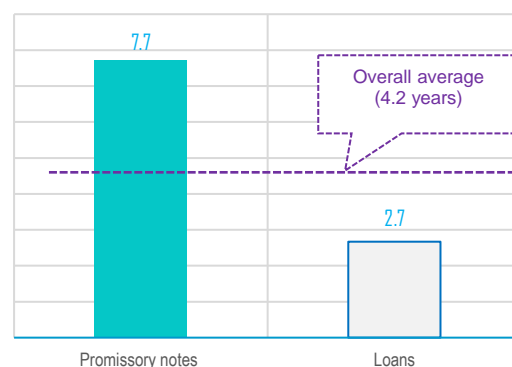
This section discusses the time required to repay a non-performing loan. If we classify the total number of non-performing assets by term, half of them, or about 330 loans, were settled within 4 years (Figure 8). However, considering the number of bills paid, it took a relatively long time, more than 4 years.

Figure 7: Distributions of numbers of NPL repaid (in terms of the period)



Source: Bank of Mongolia

Figure 8: Average period required for repayment of NPL (in years)



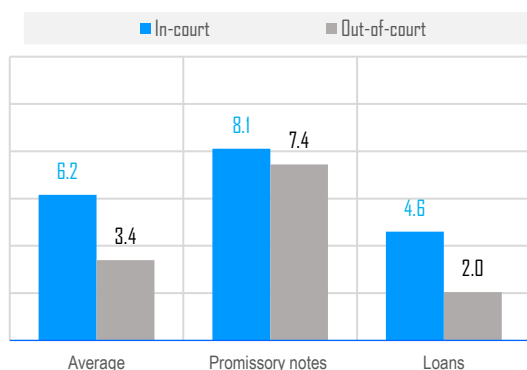
Source: Bank of Mongolia

The total average time required to settle all non-performing assets is 4.2 years. In terms of assets, the term of the promissory note is 7.7 years and the loan is 2.7 years.

Of these, the minimum time spent on court-settled assets is 134 days and the maximum is 6,058 days or 16.6 years (including the time taken by the three-tier courts and the Executive Agency of Court Decision (EACD)). The minimum time spent on non-judicial assets is 4 days and the longest period is 4633 days or 12.7 years. In addition, the longest repayment period since the date of the loan was 24.5 years, and the loan was provided by Mongol Post Bank in 1993.

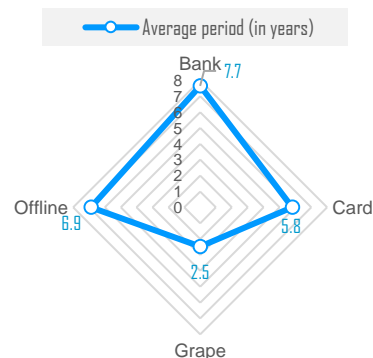
Also, the time required to repay a non-performing loan varies. For example, it takes an average of 6.2 years to resolve a court case, while a non-judicial process takes twice as long, 3.4 years. This is the same trend in terms of asset forms, as both promissory notes and loans take longer to settle in court.

Figure 9: Average period of repayment of NPL settled in court (in years)



Source: Bank of Mongolia

Figure 10: Average period required for repayment of NPL by loan registration software



Source: Bank of Mongolia

Non-performing loans have different repayment periods due to differences in banking registration software. For example, due to the transition to Grape software, the loan repayment period has been reduced to 2.5 years (Figure 10).

Table 1: Average period of execution of court decision for NPL repayment

	Amount /millions of ₮/	% of	Nnumber of
Loans settled in court	6167.8	100%	198
of which: Court decisions executed by GEACD	3449.0	56%	108
Otherwise	2718.8	44%	90

Source: Bank of Mongolia

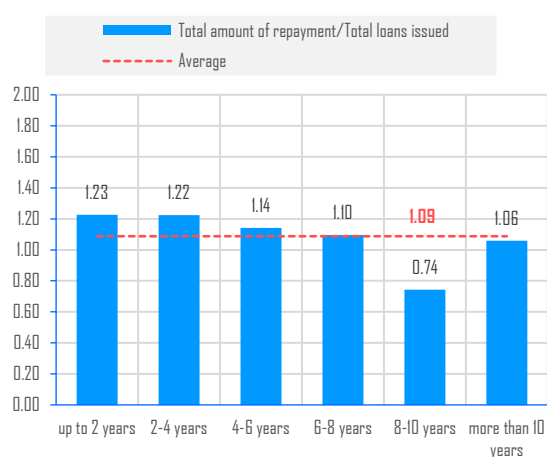
Of the 198 loans totaling MNT 6,167.8 million, 56% or 3,449 were repaid through the EACD⁵, while the remaining 44% or MNT 2718.8 million were repaid without access to the EACD.

2.2 Amount of non-performing loan repayment

This section discusses the amount of non-performing loans repaid. Figure 10 compares the total loan outstanding with the amount repaid or repaid in terms of the time taken to repay the loan. For example, for loans that have been repaid for up to 4 years, the loan amount has been repaid by an average of about 22 percent of the original loan amount.

However, when the loan maturity was extended and it took about 8-10 years, about 74 percent of the loan balance was repaid. Looking at the total amount between 2013 and 2019, loans of MNT 20.0 billion were repaid to MNT 22.6 billion, or 108% of total loans.

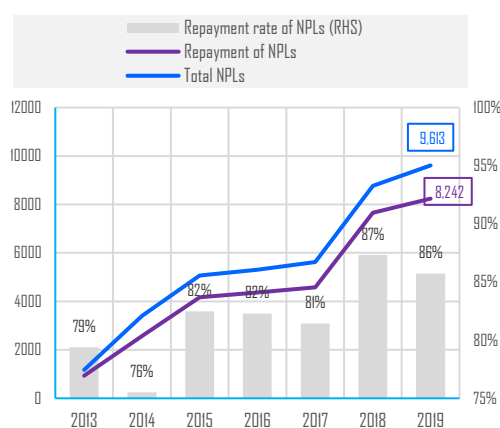
Figure 111: Ratio of repaid loans to total loans issued



Source: Bank of Mongolia

*- Total amount of repayment includes repaid NPLs

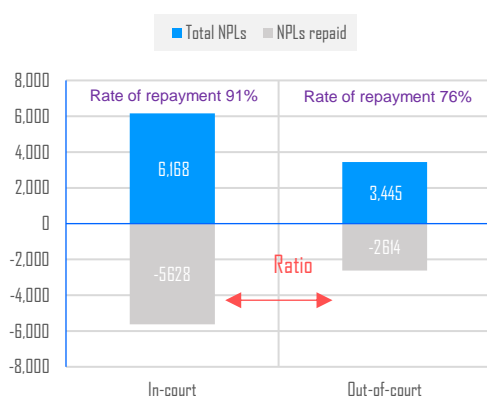
Figure 12: Repayment of NPLs (millions of ₮)



Source: Bank of Mongolia

In terms of non-performing loans, 5,628 out of MNT 6,168 million were repaid, or 91% of the non-performing loans. Non-judicial loans, on the other hand, have a relatively low repayment rate of 76% (Figure 13).

Figure 13: NPLs settled in-court and out-of-court (millions of ₮)



Source: Bank of Mongolia

Table 2: Claims and enforcement of court decisions

	Number of NPLs	Amount of NPLs /millions of ₮/
Claims	198	9,663
Enforcement of court decision	175	8,748
Claim settlement ratio	88%	91%

- Of the 198 loan claims, MNT 9,663 million, of which MNT 8,748 million of 175 loans were paid by the court.
- Therefore, the percentage of court-satisfied claims is 88-91%.

Source: Bank of Mongolia

⁵ Executive Agency of Court Decision

If we look at the percentage of claims satisfied by the court at intervals, 153 loan claims amounting to MNT 7,298 million were resolved with the highest percentage or 90-100%.

Figure 14: Interval of claims settlement ratio (in terms of the amount of NPLs)

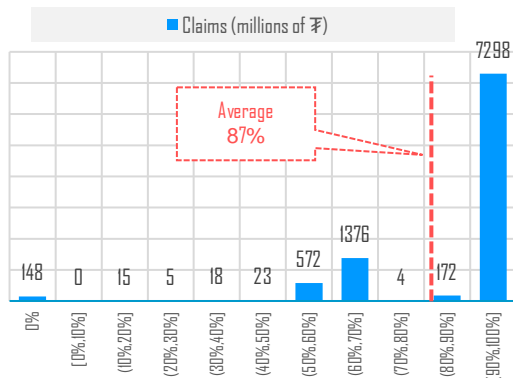
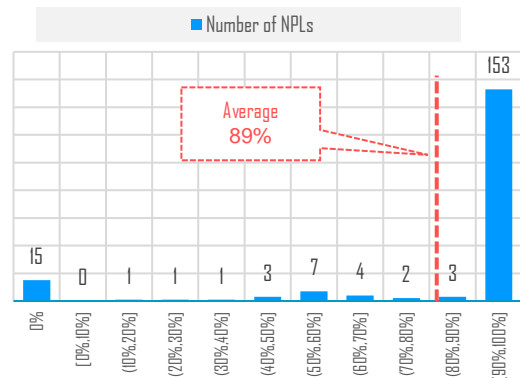


Figure 15: Interval of claims settlement ratio (in terms of number of NPLs)

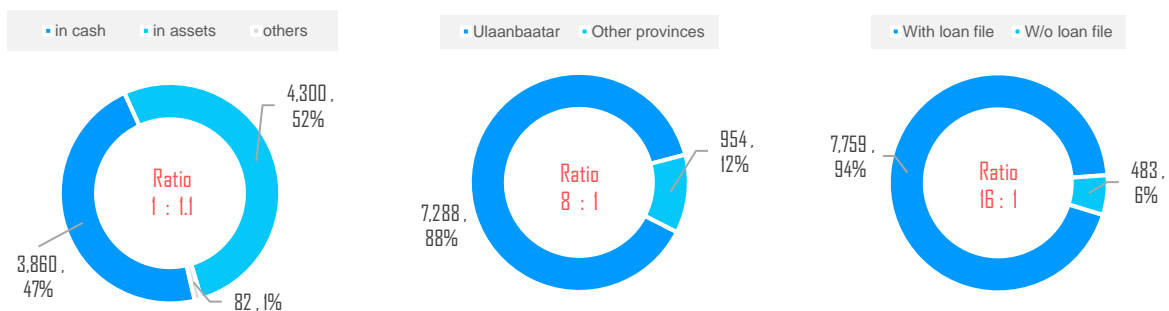


Source: Bank of Mongolia

Source: Bank of Mongolia

Figure 15 compares the amount of non-performing loans repaid by specific categories.

Figure 16: Repaid NPLs (by classifications, millions of ₮)

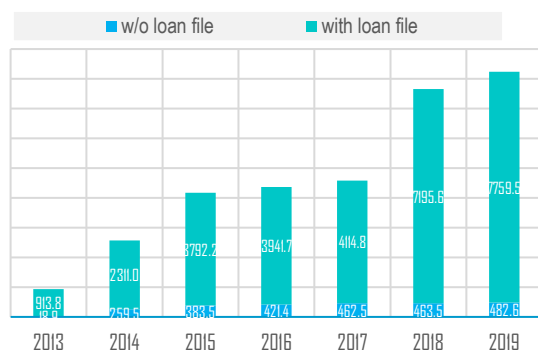


Source: Bank of Mongolia

- Non-performing loan repayment in Ulaanbaatar is 8 times higher than in rural areas.
- The amount of non-performing loans repaid in cash is 1.1 times higher than the amount repaid in assets.
- Non-performing loan repayment with loan profiles is 16 times higher than that without loan profiles.

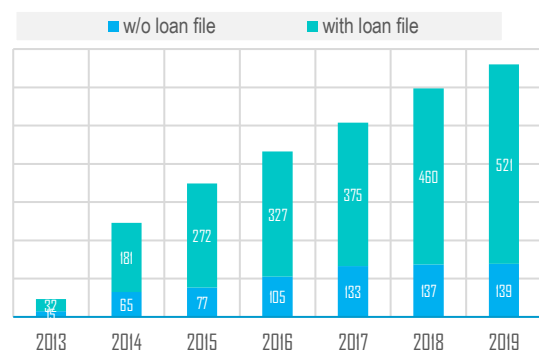
The amount and number of repayable loans for loan profiles and non-loan profiles are shown in detail in Figures 17,18.

Figure 17: The amount of NPLs repaid (millions of ₮)



Source: Bank of Mongolia

Figure 18: The number of NPLs repaid



Source: Bank of Mongolia

3 THE DATA AND METHODOLOGY

As stated in section 1, data information is collected by the receiver of Savings Bank JSC. Meanwhile, econometric analysis based on the total of 624 non-performing assets from July 22, 2013 to December 31, 2019.

In this section, we estimate empiric models, linear regression models, in order to evaluate specific factors affecting repayment period and rate as in research questions. The regression models are specified in equation 1.

$$Y_{ji} = \alpha_0 + \alpha_1 X_i + e_i \quad (1)$$

The dependent, y_{1i} is years required for NPL resolution (Model 1), whilst y_{2i} is NPL repayment rate that (Model 2). The dependent variables are identical in both models and determined as follows:

$$x_1 = \begin{cases} 1, \text{ if NPLs settled in – court} \\ \text{otherwise } 0; \end{cases}$$

$$x_2 = \begin{cases} 1, \text{ asset type is promissory notes} \\ \text{otherwise } 0; \end{cases}$$

$$x_3 = \begin{cases} 1, \text{ if registration system is Grape system} \\ \text{otherwise } 0; \end{cases}$$

$$x_4 = \begin{cases} 1, \text{ if borrower is individual} \\ \text{otherwise } 0; \end{cases}$$

$$x_5 = \begin{cases} 1, \text{ loans issued in UB} \\ \text{otherwise } 0; \end{cases}$$

$$x_6 = \begin{cases} 1, \text{ NPLs is in domestic currency} \\ \text{otherwise } 0; \end{cases}$$

$$x_7 = \begin{cases} 1, \text{ NPLs are resolved thorough EACD} \\ \text{otherwise } 0; \end{cases}$$

$$x_8 = \begin{cases} 1, \text{ if NPLs paid in cash} \\ \text{otherwise } 0; \end{cases}$$

$$x_9 = \begin{cases} 1, \text{ if borrower has loan proprofile} \\ \text{otherwise } 0; \end{cases}$$

e_i is residual term that is normal i.i.d. The model parameters are estimated via OLS techniques and estimation result is shown in Table 3.

Table 3: OLS estimation result

Variables	(Model 1) y_1	(Model 2) y_2
In-court	1.289*** [0.270]	0.0725** [0.0332]
In-court*EACD	0.18 [0.302]	0.0294 [0.0326]
Promissory notes	2.636*** [0.327]	0.0306 [0.0334]
Grape system	-2.664***	0.0595*

	[0.351]	[0.0376]
Individual	-0.0885	-0.0603
	[0.744]	[0.146]
Ulaanbaatar	-0.0364	0.0422**
	[0.189]	[0.0192]
In domestic currency	-0.173	0.298
	[0.800]	[0.211]
In cash	-2.426***	0.585***
	[0.263]	[0.0477]
With loan proprofile	0.661***	0.0844**
	[0.181]	[0.0365]
Constant	6.530***	-0.0662
	[1.067]	[0.251]
Observations	624	624
R-squared	0.664	0.374

Robust standard errors in brackets

*** p<0.01, ** p<0.05, * p<0.1

According to the OLS estimation result in Table 3, in-court has significantly positive impact on both dependent variables, period of repayment and repayment rate, at 1% significant level. When NPLs are settled in-court the repayment period is 1.3 years greater than out of-court at. The step-by-step process of enforcing a court decision will be carried out in accordance with the law, even if the 'unnecessary' process is repeated, some activities are omitted, every action required by the law is delayed, and all legal measures are taken. It can be time-consuming and can lead to ineffective deadlocks. However, repayment rate is 7 percent higher than in case of out-court. That means although NPLs are settled in court takes more time, repayment rate is higher than out-court process or going for negotiating.

In addition, if banking registration is Grape software, the loan repayment period has been reduced by 2.6 years and repayment rate is 6% higher than other software.

In the case of the EACD, the loan repayment period has been slightly extended by 0.19 years but it is not statistically significant. Loans to legal entities are repayable over a relatively long period of time, which means that some loans can be borrowed through another company, run the business, the company has no real assets, no location, is a 'paper company', and has many other loan liabilities.

Moreover, depending on the location of the receiver and the availability of manpower, the lender has more communication and control over the loan if the borrower resides in Ulaanbaatar. As a result, Ulaanbaatar has repaid more loans (repayment rate is 4% higher than other areas) that have not been repaid for many years and are more difficult to repay than loans issued in the local area. The same is true for loans with loan proprofiles.

The receiver seeks to repay the loan in cash, and if it is not possible to repay the loan in cash and it takes a long time to repay in cash, the borrower assets are taken to repay the loan. Therefore, in terms of time, it took longer than a loan repaid in cash.

4 CONCLUSION

This study is the first of its kind to attempt to determine the average maturity and average repayment rate of non-performing loans. The average maturity of non-performing loans is 4.2 years and repayment rate is 83 percent. Although the repayment rate of loans and receivables was high in the first years of the receiver's appointment, the repayment rate has been declining over time.

However, the amount of non-judicial payments was relatively small compared to the amount of loans and receivables paid in-court, but in terms of time, it took almost 1.3 years more. The minimum time spent on judicial assets was 134 days (0.4 years) and the maximum was 16.6 years, while the time spent on non-judicial assets was a minimum of 1 day and a maximum of 12.7 years. Non-performing loans in Ulaanbaatar are eight times greater repayment rate is 4% higher than in rural areas and. The repaid amount of non-performing loans with loan profiles is 16 times higher than the repaid amount of non-performing loans without loan profiles. If borrower has loan profile NPL repayment period is 0.6 years less and repayment rate 8% higher is than one without profile.

Based on the above facts of non-performing loans of Savings Bank JSC, it is important to reduce non-performing loans in the financial sector, solve them in an economically efficient and international standard way, and reduce total costs related to asset management and non-performing loans. Therefore, it is concluded that legislators and policymakers need to determine the best way to repay non-performing loans, create the necessary legal environment for its implementation, and take economic and financial measures in the near future.

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