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MODERN FOREIGN METHODOLOGIES FOR ASSESSING CUSTOMERS' CREDITWORTHINESS AND THEIR APPLICATION IN NATIONAL PRACTICE

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Abstract

A correct and comprehensive assessment of a customer's creditworthiness is the primary and most important tool of credit risk management at the pre-lending stage, because errors made at this stage subsequently become the main source of problem loans. It is therefore of practical importance to study foreign countries' methodologies for assessing creditworthiness and to identify those elements that can be applied in national practice.

In the practice of US commercial banks, the "6C" rule is used to assess the creditworthiness of corporate customers. Under this rule, the customer's character (Character), meaning its previous credit history and reputation; its capacity (Capacity), meaning its financial condition and the analysis of its liquidity and financial ratios; and its capital (Capital), meaning the ratio of own to borrowed funds and the quality of assets, are analyzed comprehensively together with a number of additional financial and non-financial criteria, such as collateral, general economic conditions, and the ability to exercise control [1]. This multi-criteria approach makes it possible to evaluate a customer not only by its current financial condition but also in terms of its future stability and resilience to the external environment.

The international rating agency Standard & Poor's, in assessing the creditworthiness of companies, examines expected cyclical downturns and



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upswings in business activity, paying particular attention to analyzing changes both within the industry and across the economy as a whole; since the duration and depth of the phases of the business cycle may differ significantly, assessing their impact on companies' debt-servicing capacity is a complex process [2].

Table 1. Risk weights by credit rating under the standardized approach recommended in the Basel II standard, % [4].

Credit rating	Sovereigns and central banks	Credit institutions	Corporate entities
AAA to AA	0	20	20
A+ to A-	20	50	50
BBB+ to BBB-	50	100	100
BB+ to BB-	100	100	100
B+ to B-	100	100	150
Below B-	150	150	150
Unrated	100	50–100	100

On the basis of the ratio of an enterprise's total cash flow to its total debt obligations, creditworthiness is divided into six classes (I–VI), with the range of this indicator from 0.75 to 0.15 determining the respective classes [3]. The methodological basis of this approach is that cash is the asset with the highest degree of liquidity, and in repaying commercial bank loans the funds in an enterprise's current account are regarded as the primary source [3]. A comparison shows that whereas a New York bank uses four financial ratios in assessing a customer's creditworthiness, in the practice of Uzbekistan's large commercial banks only one of these ratios — the current liquidity ratio — is used, and normative levels have not yet been set for the additional ratios [3]. This indicates that the national assessment methodology is considerably simplified in comparison with foreign practice.



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Under the Supervisory Capital Assessment Program (SCAP) introduced in the United States in 2009, 19 large bank holding companies — each controlling at least one bank and together accounting for two-thirds of total banking assets — were subjected to mandatory stress testing in the manner prescribed by the regulator [3]. The introduction of this program was explained by the bankruptcy of hundreds of US banks during the 2008 global financial and economic crisis, the main cause of which was attributed to banks' capital being insufficient to cover the losses incurred [3].

An analysis of foreign methodologies shows that the high quality of creditworthiness assessment depends on a balanced combination of quantitative analysis (based on financial ratios) and qualitative analysis (the customer's management capability, market reputation, and the stability of its business model). Relying solely on quantitative ratios, especially for enterprises operating in rapidly changing sectors of the economy, may fail to capture future risks fully. This increases the institutional importance, in the credit decision-making process, of independent credit committees and internal validation mechanisms for risk assessment, as opposed to individual decision-making. According to international experience, such a collegial decision-making system significantly reduces the credit risks that arise from the incorrect decisions of an individual responsible officer or from decisions driven by conflicts of interest.

It should also be emphasized that the methodology for assessing creditworthiness must differ fundamentally between legal entities and individuals: whereas for corporate customers financial statement analysis and cash-flow-based assessment are of primary importance, for retail customers indicators such as income stability, credit history, and the debt-to-income ratio take on greater significance. Applying a single, universal assessment model to both segments increases the



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likelihood of misjudging credit risk; therefore, a segmented assessment methodology needs to be developed.

As the data in Table 1 above show, loans extended to borrowers with a low credit rating, or with none at all, require the bank to hold a significantly higher capital reserve, which means that working with unrated customers imposes an additional capital cost on the bank. Given that most customers in the national banking system have not been rated by international rating agencies, developing an internal credit rating system makes it possible, on the one hand, to differentiate credit risk more precisely and, on the other, to allocate capital more efficiently. In our opinion, the following measures would significantly increase the ability to identify credit risk at an early stage and to prevent the emergence of problem loans: expanding the set of financial ratios used to assess customers' creditworthiness in national banking practice (in particular, making the quick liquidity ratio and the financial independence ratio mandatory); subjecting large borrowers to a periodic stress-testing system similar to the US SCAP program; and developing a methodology for assessing the non-financial criteria of the "6C" rule (the customer's character and the quality of its management).

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