

CURRENT STATE OF COLLATERAL VALUATION AND IMPROVEMENT OF THE VALUATION OF SECURITIES AS COLLATERAL IN CREDITING BY BANKS: EVIDENCE FROM UZBEKISTAN

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Abstract

At present, there are many commercial banks that offer reasonable rates for bank loans. But still some companies and individuals cannot get bank loan because of collateral requirements. Of course there are many types of assets that can be used as collateral. However, determining their real value remains tough. Nowadays real estate, vehicles, jewelry, and inventory, securities and other types of assets are used as collateral in Uzbekistan. Although at present intangible assets are accepted as collateral in developed and most developing countries, in Uzbekistan this practice is not used. Due to the fact there is not a proper method to determine real value of securities. However it should be improved step by step. This paper studies current state of collateral valuation and gives some proposals to improve the valuation of securities as collateral.

Keywords: Collateral, securities, valuation, bank loan, Uzbekistan

INTRODUCTION

Globalization of the world economy, frequent happen of global financial and economic crises, as well as the intensification of market relations in Uzbekistan and the increased demand for bank assets management, especially the problem of minimizing the risk in bank lending increase the importance of collateral assessment. Since the early years of independence, the process of assessment relations has evolved. If the assessment was initially used in the process of privatization of the state property, then it was transformed and continually improved as a major

economic category in the relationship between businesses on trading movable and immovable assets.

Along with these processes, the practice of assessing the bank loan collateral was formed and developed on the basis of market requirements. At present, one of the main types of collateral for the provision of bank loans has become one of the most pressing issues. While assessing the value of the collateral all probable risks should be taken into consideration. As it is known, one of the main principles of the loan is its "provision". The Bank pays a special attention to this principle before making a loan agreement to minimize and manage the credit risk associated with the creditor. The Bank is interested in qualitative, fair valuation of the movable or immovable property being accepted for collateral. The borrower can be an individual or a legal entity that has movable or immovable property assessed, as collateral for a bank loan. In this process, the potential borrower concludes a contract with a valuation institution that assesses the movable or immovable asset being valued. The Bank does not take part in transactions involving assessing collateral between the borrower and the appraiser. The participation of the bank in this process may be after the appraiser's transfer of the assessment report to the bank. According to our researches we have found out that in some cases the amount of money that is acquired from selling the collateral is not enough to cover the bank loan. This is due to the following situations:

- Non-compliance of the report on collateral with the requirements of the current legislation and regulatory documents;
- Determined price and real market price of movable and immovable assets differ from each other;
- Uncertainty in assessment and not consideration all situations that may impact;
- Choice of inappropriate method of assessment;

The aforementioned facts do not only cause losses due to problematic loans on bank loans, but also reduce the position of valuation institutions in the market, loss of confidence in their activities and decrease the demand for their services.

When studying foreign practice on this issue, the Bank's loan in developed and developing countries is based on the state of socio-economic relations of the country, as well as the process of the valuation of real estate.

In some countries, there is an obstacle for businesses in getting bank loans. It is related to the requirements on collateral for bank loans. In 2006, the World Bank surveyed businesses to identify the problem that are faced by banks in acquiring credits from banks.

Why companies and firms are unable to obtain loans from banks?

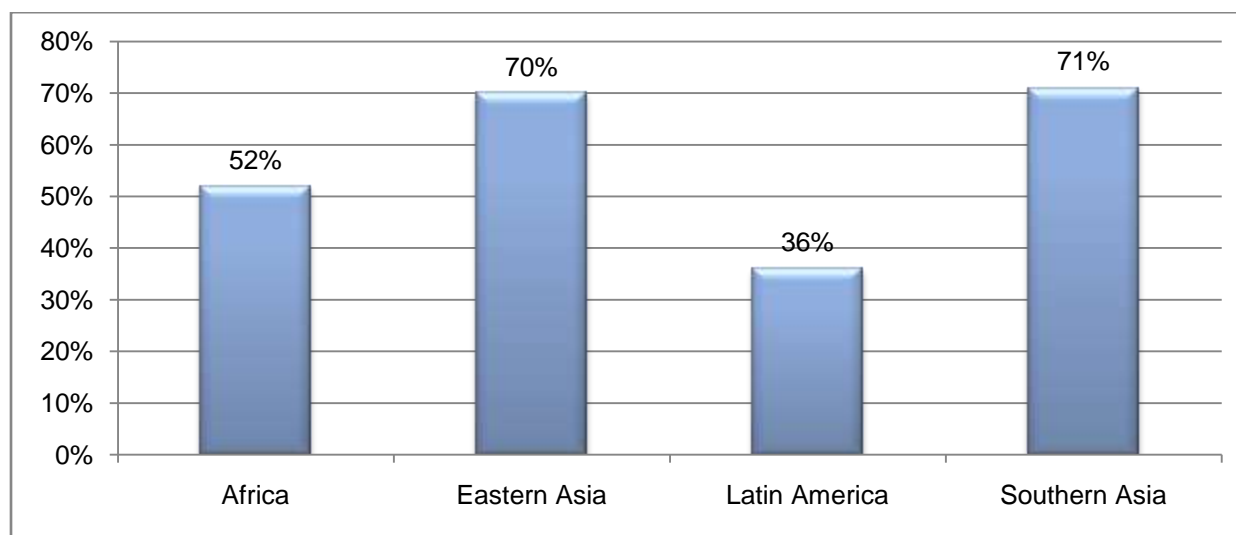


Figure 1: Dynamics of businesses that are unable to obtain bank loans due to the lack of sufficient assets to meet collateral requirements

Source: World Bank Enterprise Surveys Global Database

Figure 1 shows that, due to the demand for collateral for loans, enterprises and firms in those regions did not have access to loans from the bank. In Eastern and South Asian countries, the number of enterprises with problems with obtaining a bank loan due to the lack of assets was 70% and 71% respectively of the total number of enterprises. In Africa this figure accounted for 52%, the lowest indicator was in Latin America.

We all know that bank loans serve as one of the main sources of financing for the enterprises of the real sector. From the information above, 70% of enterprises have problems with obtaining bank loans, which directly affects the economic growth in the country.

Although it took place in 2006, there are still some problems related to the valuation of the collateral. Why could not they obtain bank loans? Because collateral requirements were very high. Why were they high? Because valuation institutions could not chose the best method to evaluate the collateral. That's why banks required higher amount to collateral in order to decrease the riskiness of the bank loans. There are three approaches to evaluate the value of the collateral.

Cost approach. The value of an asset can be determined by the cost to replace or reproduce it. Under this approach, appraisers factor in functional and operational obsolescence. When valuing investments in private company stock using this approach, an appraiser would subtract liabilities from the combined fair market values of the company's assets.

Market approach. An asset is worth as much as other assets with similar utility in the marketplace under this approach. With investments in private company stock, for example, an appraiser might look at recent transactions involving other companies in the same industry and compute pricing multiples from those comparables.

Income approach. Investors pay for the expected cash they'll receive every year from an asset and when the asset is eventually sold (or salvaged) in the future. Often appraisers "discount" future earnings based on the asset's risk, using a discounted cash flow analysis.

Table 1. Collateral accepted by loan type.

Personal loan	Business loan	Auto loan
➤ Personal real estate	➤ Securities	➤ The vehicle you're purchasing
➤ Home equity	➤ Blanket lien	➤ Personal vehicles you already own
➤ Personal vehicles	➤ Business or personal real estate	➤ Home equity
➤ Paychecks	➤ Home equity	➤ Investment accounts
➤ Cash or savings accounts	➤ Business property like machinery or specialized equipment	➤ Paper investments
➤ Investment accounts	➤ Business or personal vehicle	➤ Cash or savings accounts
➤ Paper investments	➤ Farm assets and products	
➤ Such valuables as fine art, jewelry or collectibles	➤ Accounts receivable	
	➤ Inventory	
	➤ Natural reserves	
	➤ Insurance policies	
	➤ Investment accounts	
	➤ Paper investments	
	➤ Business savings accounts	
	➤ Such valuables as fine art, jewelry or collectibles	

Nowadays, securities are considered one of the main sources making profit. Therefore, in our paper we would like to focus on valuation of securities as collateral.

Valuation of securities as collateral in crediting by banks

In fact, It is difficult to use securities as collateral in Uzbekistan. Because, the secondary market for financial instruments does not work well. But it is being developed nowadays. Because, the first IPO practice is going to be organized in Uzbekistan by JSC "KVARTS". The joint-stock company issued 4.57 million shares (nominal 1715 soums) for a total of 7.84 billion soums, for

their initial public offering (IPO). The issued shares make up 10% of the charter capital of the company. It means, in recent years, it is more likely to appear many enterprises that organize IPO. As a result, securities could be used as collateral. At present securities are accepted as collateral for bank loan, but not all of them. Moreover there are not certain methods to determine its value. In the paper, some ways to determine the value of securities are recommended.

If a business or an individual offers securities as collateral for a bank loan, the bank will need an independent valuation of the securities. In valuation their market value correctly, an expert such should consider characteristics such as their type (stocks, bills of exchange); issuer; whether they are listed on the stock exchange or traded in over-the-counter market. If securities are quoted on the open market, then it is not difficult to determine their value, since it is already determined by the market. As a rule, the most objective price of quoted shares is the closing price of the previous exchange day. In case of securities do not have stock quotes and there is no information on prices on them on the OTC market, the current state of the financial market, information on the reliability of the issuer, on the stability of its financial state, yield of a security are analyzed. The changes in prices for securities, including a decline should be taken into consideration. In this regard, the bank monitors the situation and it has the right to require the borrower to replenish the collateral to reduce its own risk of non-repayment of the loan.

An independent valuation of the market value of shares is determined on the basis of certain methods. These methods take as basis different values of shares: liquidation, balance, recovery, profitability of shares, dividend income. In addition, in order to properly assess the value of shares, it is necessary to take into account other factors, for example, such as: the status of shares (common or preferred); the size of the portfolio of shares (small, blocking, control).

When valuing shares for **liquidation value**, the basis for calculations is the amount that owners of shares will receive if the joint-stock company is liquidated and its assets are sold.

When valuing shares at the **balance value** of assets, accounting (which is reflected in the balance sheet) is taken as the basis, and not the real prices of the assets of the joint-stock company, so the error is inevitable. The balance value of shares is calculated on the basis of the book value of fixed and current assets, minus long-term and short-term liabilities of the JSC.

When valuing shares at **recovery value**, the basis is the amount that would be spent when replacing the assets of the JSC in their current state and at current prices. In other words, if the enterprise has equipment that has worked half of the service life, and new equipment costs 2 million UZS, it means that the recovery cost of the equipment is 1 million UZS.

When valuing shares by their **profitability value**, their value is defined as a financial instrument that brings profit to its owner. The main ways to profit are dividends and the growth

of the share price, due to the improvement of the financial condition of the JSC, expansion of business and growth in the value of assets. The measure of the profitability of the stock is the profitability of the joint-stock company. The yield of a stock is understood as the ratio of earnings per share to its price, expressed as a percentage.

When assessing shares for **dividend income value**, the amount of accrued dividends is taken as a basis. Dividend income is the ratio of the amount of dividends paid on a share to the price of a share, expressed as a percentage. Using this valuation technique, it is assumed that in the future the dividend amount will remain unchanged. If the joint-stock company does not pay dividends to shareholders, but directs profits to capital increases or to the development of the enterprise, then this method cannot be used to evaluate shares.

CONCLUSION

As a result of the research carried out within the framework of collateral evaluation, we have compiled the following conclusions and recommendations:

- At present stage of development of activity of valuation institutes it is necessary to pay great attention to increase of transparency and practical significance of their conclusions;
- Under conditions of market economy one of the main conditions of elimination of financial risks of commercial banks and reduction of credit risk is collateral and its true assessment;
- Securities should be as collateral, because, firstly, it increases the demand for securities and more enterprises would be able to get bank loan. But in order to determine their real value, there should be certain methods that would be supported by a lender and a borrower;
- In order to determine the real value, one of the abovementioned valuation ways should be chosen depending on the type and status of the securities;

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