YANGON UNIVERSITY OF ECONOMICS

DEPARTMENT OF COMMERCE

MASTER OF BANKING AND FINANCE PROGRAMME

COMPLIANCE OF BASEL CREDIT RISK MANAGEMENT PRINCIPLES IN UAB BANK LIMITED

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DECEMBER 2019

ABSTRACT

This thesis intends to identify credit risk management of UAB and analyses the compliance status of Basel credit risk management principles in UAB. To explore these objectives, the descriptive method is used, and secondary data are collected from Central Bank of Myanmar, Internet website, Library and UAB annual report. Regarding of objectives, it found that credit risk management in UAB is very effective and comply with Basel credit risk management principles. Appropriate credit risk environment is established as per Basel credit risk management principle topic no.1. Policies and procedures are clearly defined, ceiling of loan segments is set, and loans spread to different industries, different business segments and different geographical areas. Procedure for granting new loans and renew loans are in place and delegation of lending authority is given to different authority levels. Credit recovery and follow up procedures are in place and NPL is well controlled. UAB adopts 3-Tier ratings system and it found very effective in controlling NPL. Appropriate credit administration, measurement and monitoring process are maintained. However UAB needs to practice more international Credit risk assessment methods such as moving to latest Basel Guidelines on credit risk capital, provision requirements, insist for more documentary evidences on financial status of the borrowers to assess real financial strength of the borrower to reduce collateral requirements, introduce more loan products suitable for various industries, ensure proper usage of funds disbursed to borrowers, more stringent follow up methods etc.

ACKNOWLEDGEMENTS

Upon completion of this paper, I would like to convey my heartiest thanks to all of those who have contributed much and assisted me in various ways in all times before, during and after the preparation of this paper.

Firstly, I would like to express my sincere gratitude to Prof. Dr. Tin Win, Rector, Yangon University of Economics, for his concern and good academic guidance to the participants of the MBF Program and my deepest thanks to the Prof. Dr. Nilar Myint Htoo, Pro-Rector.

My sincere appreciation is extended to Prof. Dr. Soe Thu, Head of Department of Commerce and Program Director of Master of Banking and Finance as well as my Supervisor for her kind effort, good contribution and great encouragements to MBF program and guidance to successfully finished this paper.

I also would like to thank my superior, Mr. Mathew Kottaplackil (Director) UAB bank Ltd. He recommended the research idea to me and helped me a great deal in collecting secondary data for this study. And finally, all the UAB staff especially from Credit Management Department who contributed to this paper, without their helping hands, this report would have not been completed in time.

Last, but not the least. I would like to say deepest thanks to all my family members, friends, and colleagues who give me the strength and encouragement to accomplish my academic goal.

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CHAPTER 1

INTRODUCTION

Risk management is major concept in bank and financial sector because it has effect not only on the behavior of financial institution, but also economy of a country as well as entire world. For that reason, the risk management issue is paid increasingly more interest in every stage of any enterprise over the world. In addition, as financial industry turning into more competitive in addition to complex, bankers and financial managers have been shifted away from attention on profit or spread towards to risk pricing. In other words, it is not only enough to earn high return rate on an investment; but also, important that earned return compensates the banks properly for the risk that is taken. Hence, the quantifying risk and finding optimal mix between taking risks, maximizing returns by creating own capital provisions are vital for financial world. Main risks faced by financial institutions fall into the broad categories-namely credit, market, liquidity and operational risks.

Among the risks faced by banks, credit risk is the most important and credit risk management issues have been evolved dramatically for last twenty years by driving some forces: competition on financial market is getting more severe, increased number of bankruptcy over the world declining value of real assets in many markets and a dramatic growth of off-balance sheet instrument with inherent default risk exposure. The major cause of serious banking problems continues to be directly related to lax credit standards for borrowers and counterparties, poor portfolio risk management, or a lack of attention to changes in economic or other circumstances that can lead to a deterioration in the credit standing of a bank's counterparties. This experience is common in all countries.

Credit risk is the possibility of a loss resulting from a borrower's failure to repay a loan or meet contractual obligations. The goal of credit risk management is to maximise a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Banks need to manage the credit risk inherent in the entire portfolio as well as the risk in individual credits or transactions. The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organisation.

The Basel Committee issued the principals of credit risk management in year 2000 in order to encourage banking supervisors globally to promote sound practices for managing credit risk. The sound practices set out specifically address the following areas: (i) establishing an appropriate credit risk environment; (ii) operating under a sound credit granting process; (iii) maintaining an appropriate credit administration, measurement and monitoring process; and (iv) ensuring adequate controls over credit risk.

1.1 Rationale of the Study

Banking sector is one of the fastest growing sectors in Myanmar. Ther are 25 private banks are operating in Myanmar (as per CBM). Some new banks are also coming in the market. Therefore, the banking industry is very much lucrative and at the same time very competitive too. In this competitive business, banks play a significant role in every sectors of economy and that's why banks are called the operator of the economy. If the banks fail to ensure the security of the deposit money and loan disbursement then the whole economy will on threat. Credit risk has been studied a lot across the development of banking as a popular topic in the industry. Nevertheless, as long as banks practice their core functions, which are credit activities, this issue never goes old.

All banks are offering newer products and facilities to attract the customers and retain them. Appropriate customer selection and retention is vital for bank profitability. In case of sanctioning credit selection of borrowers, credit investigation is must. Not only these but also preparation of credit report credit approval process & administration following proper credit risk management is crucial for any bank. Because if there is any lack in credit management the loan may default this may run a bank in bankruptcy.

Since exposure to credit risk continues to be the leading source of problems in banks world-wide, banks and their supervisors should be able to draw useful lessons from past experiences. Banks should now have a keen awareness of the need to identify, measure, monitor and control credit risk as well as to determine that they hold adequate capital against these risks and that they are adequately compensated for risks incurred.

Regarding this aspect, in July 2017, the CBM issued new regulations to implement several Basel II standards. In particular, the CBM established a minimum liquidity ratio of 20 percent and required banks to calculate liquidity daily and report figures weekly to the CBM. The CBM also set the limit on lending exposure to any single counterparty at 20 percent of capital and reserves, though state-owned banks remain exempt from this requirement when lending to government entities. The degree to which Myanmar should adhere to all Basel standards—and the implications of partial adoption—remain an area of discussion for the banking sector, its regulators, and international observers.

In previous years, UAB had not proper credit risk management system same as other banks in Myanmar. From 2014 onwards, UAB started setting up the proper credit risk management system to control the asset quality of their loan portfolio. Therefore, this study intends to identify the credit risk management practices used in UAB and to analyse the compliance status of Basel credit risk management principles in UAB.

1.2 Objectives of the Study

The objectives of the study are as follows:

- To identify the credit risk management practices in UAB
- To analyse the compliance status of Basel credit risk management principles in UAB

1.3 Method and Scope of the Study

In the study, a descriptive method is used. Among the 25 private banks in Myanmar, this study is focus in Credit Risk Management System of UAB Bank. Primary data are collected from Face-to-Face interview with the respective officers and staffs, relevant file study provided by the officers concerned. Secondary data are collated from credit manuals issued by UAB Bank, UAB Bank Annual Report, relevant books, research papers, newspapers and Journals, Internet website and various study selected reports.

1.4 Organization of the Study

This research is inclusive of five sections to achieve of the objectives. Chapter 1 explores the overview of the research which includes the introduction, rationale of the study, objectives of the study, research methods and organizations of the study. Chapter 2 states the theorical background of the credit risk management and principals of credit risk management set by Basel committee. Chapter 3 describes the profile of UAB Bank and Status of credit risk management in UAB Bank. Chapter 4 presents the analysis of the data and interpretation. Chapter 5 involves the conclusion of the research study, finding and recommendation of the research.

CHAPTER 2

THEORIETICAL BACKGROUND

This chapter consists of Major types of risk in banks, Credit Risk Management Policies, Factors causing credit risk and Principles for the Management of Credit Risk set by Basel Committee.

2.1 Major Types of Risks in Bank

Bank for International Settlement (BIS) has defined it, as "Risk is the threat that an event (or) action will adversely affect an organization's ability to achieve its objectives and successfully execute its strategies. Risk is the probability of the unexpected happening, the probability of suffering loss.

Banking is the intermediation between financial savers on one hand and the fund and the funds seeking business entrepreneurs on the other hand. As such in the process of providing financial services, bank assumes various kinds of risk both financial and non-financial. Financial risk arises from any business transaction undertaken by a bank, which is exposed in potential loss.

Non- financial risk refers to those risks that may affect a bank's business growth, marketability of its product and service, likely failure of its strategies aimed at business growth. These risks have been grouped in different ways to develop the risk management for the various analysis but the common ones, which are considered in this study, are credit risk, liquidity risk, operational risk and transaction risk and compliance risk.

1) Credit Risk

Credit risk defined as the chance that a debtor or financial instrument issuer will not be able to pay interest or repay the principal according to the terms specified in a credit agreement – is an inherent part of banking. Credit risk means that payments may be delayed or ultimately not paid at all, which can in turn cause cash flow problems and affect a bank's liquidity. Despite innovation in the financial services sector, credit risk is still the major single cause of bank failures. The reason is that more than 80 percent of a bank's balance sheet generally relates to this aspect of risk management.

2) Liquidity Risk

Liquidity risk is the risk that a company or bank may be unable to meet short-term financial demands. This usually occurs due to the inability to convert a security or hard asset to cash without a loss of capital and/or income in the process.

3) Operational Risk

Operational risk is the prospect of loss resulting from inadequate or failed procedures, systems or policies. Employee errors. Systems failures. Fraud or other criminal activity. Any event that disrupts business processes.

4) Transaction Risk

Transaction risk is the exchange rate risk associated with the time delay between entering into a contract and settling it. The greater the time differential between the entrance and settlement of the contract, the greater the transaction risk, because there is more time for the two exchange rates to fluctuate.

5) Compliance Risk

Compliance risk is defined as the risk of legal sanctions, material financial loss, or loss to reputation the Bank may suffer as a result of its failure to comply with laws, its own regulations, code of conduct, and standards of best/good practice. Overly restrictive, but allows for the presentation of loans to the board that officers believe are worthy of consideration but which do not fall within the parameters of written guidelines. Flexibility must exist to allow for fast reaction and early adaptation to changing conditions in a bank's earning assets mix and market environment.

2.2 Credit Risk Management Policies

Credit risk is the most common cause of bank failures, causing virtually all regulatory environments to prescribe minimum standards for credit risk management. The basis of sound credit risk management is the identification of the existing and potential risks inherent in lending activities. Specific credit risk management measures typically include following three kinds of policies-

(a) Policies to limit or reduce credit risk

(b) Assets classification of loan

(c) Loan loss provisioning policy

a) Policies to Reduce Credit Risk: Large exposure: Bank regulators have traditionally paid close attention to risk concentration by banks. A regulators objective in credit risk management is to prevent banks from relying excessively on a large may not lend. Modern prudential regulation usually stipulate that a bank not make investment, grant large loans, or extend other credit facilities to any individual entity or related group of entities in excess of an amount that represents a prescribed percentage of the bank's capital and reserves within this framework, bank supervisor's are in a unique position to monitor both the banking sector and an individual bank's credit exposure in order to protect depositor's interest and to be able to prevent situations that may put a banking system at risk.

Most countries impose a single-customer exposure limit of between 10 and 25 present of capital, although in some jurisdictions it may be as high as 30-40 percent of capital. The Basel Committee on banking supervision has recommended a maximum of 25 percentages; with the intention of reduce it to 10 percent as soon as this is practical. The threshold at which reporting to supervisory authorities becomes necessary should normally be set somewhat below the maximum limit. Supervisor can than devote special attention to exposure above the threshold and require banks to take precautionary measures before concentration becomes excessively risky. Bank credit officers should monitor events affecting large debtors and their performance on an ongoing basis, regardless of whether or not a debtor is meeting its obligations.

i) Related-party Lending: Lending to connected parties is a particularly dangerous form of credit risk exposure. Related parties typically include a bank's parent major shareholders, subsidiaries, affiliate companies, directors and executive officers. This relationship includes the ability to exert control over or influence a bank's policies and decision- making especially concerning credit decisions. A bank's ability to systematically identify and track extension of credit to insiders is crucial. The issue is whether credit decisions are made on a relational basis and according to the bank's policies and procedures. An additional concern is whether credit is based on market terms or granted on terms that are more favorable with regards to amount, maturity, rate collateral, than those provided it the general public. Most regulators establish limit for aggregate to related parties, typically stipulation that total lending to related parties cannot exceed a certain percentage of tier 1 or total qualifying capital. If such a limit has not been established by prudential regulations. A bank should be expected to maintain one as a matter of board policy. A prudent banking practice would require all loans to related parties to be approved by the board.

ii) Over Exposure to Geographical Area or Economic Sectors: Another dimension of risk concentration is the exposure of a single sector of the economy or narrow geographical region. This makes a bank vulnerable to a weakness in a particular industry or region and poses a risk that it will suffer from simultaneous failures among several clients for similar reasons. This concern is small countries with narrow economic profiles, such as those with predominantly agriculture- based economic or exporters of a singular commodity. It is often difficult to assess the exposure of bank to various sectors of the economy, as most bank reporting systems do not produce such information. For example, a loan to the holding company of a large diversified group could be used to finance projects in various industries in which the company operates. In any case, banks, which are by nature exposed to sector risks, should have well- developed system to monitor such risks and to assess the impact of adverse trends on their loan portfolio quality and on their income statements. Such banks should also have institutionalized mechanisms in place to deal with increased risk.

b) Asset Classification of Loans

This section prescribes the policies and procedures governing the classification of loans. The policies prescribed in this section shall conform to the regulations of Central Bank of Myanmar. Generally, the appropriate classification for an individual account will be determined on a case-by-case basis, based on the principles enumerated below, taking into account all relevant information currently available. Nonetheless, in order to expedite the process of evaluating the quality of loans and provisioning for possible loan losses, all loans and credit facilities should be classified in the following manner.

The terms and timelines used in these Sections acts only as a guide. They are for the purpose of highlighting the principles involved in classification of loans. When available, the terms and timelines of the Central Banks must be adopted and complied with.

i) Standard Loans: When loan is repaid in due time as determined in the contract (at the maturity date) and the financial position of the borrower is sound and payment is made in accordance with the term of the loans, The Bank is to classify those loans as standard loans.

ii) Irregular Loans (Watch Loan): The financial position of the borrower is currently adequate but potential weaknesses exist and if not corrected, will result in a deterioration of the borrower's financial position at a future time and principal or interest are delinquent for a period from 31 days to 60 days from the due date, those loans are defined as Irregular Loans or Watch Loan.

iii) Sub-standard Loans: When loans not adequately secured, the borrower's financial position is not satisfactory, the principal or interest has not been repaid for a period of 61 to 90 days from the due date, such loans are defined as Sub-standard Loans.

iv) Doubtful Loans: A loan classified as doubtful has all the characteristics of a substandard loan and credit weakness making full collection questionable and the principal or interest has not been repaid for a period of 91 to 180 days from the due date, such loans are defined as Doubtful Loans.

v) Loss Loan: Certain assets are considered uncollectible and of such little value that the continued definition as bankable assets is not warranted. This classification does not mean that an asset has absolutely no recovery or salvage value, but rather that it is neither practical nor desirable to defer the process of writing it off, even though recovery may be possible in the future. Nonperforming assets that are at least 181 days past due are also classified as losses, unless such assets very well secured.

c) Loan Loss Provision Policy

Assets classification provides a basis for determining an adequate level of provision for possible loan losses. Such provisions together with general loss reserves that are normally counted as tier 2 capital and are not assigned to specific assets form the basis for establishing a bank's capacity to absorb losses. In determining an adequate reserve, all significant factors that affect the collectability of the loan portfolio should be considered. These factors include the quality of credit policies and procedures prior loss experiences, loan growth quality of management in the lending area loan experiences, loan recovery practices, changes in national and local economic and business conditions and general economic trends. Assessments of assets value should be performed system optically, consistently over time and in conformity with objective criteria. They should also be supported by adequate documentation.

Policies on loan – loss provisioning range from mandated to discretionary depending on the banking system. The tax treatment of provision also varies considerably from country although many economists believe that provisions should be treated as business expenses for tax purposes. Tax considerations should not however influence prudent risk management policies. In some highly developed countries, it is left to the banks to determine the prudent level of provisions. While some merit exists in estimating loss potential on a case-by- case basis particularly for large borrower, it may be more practical to assign a level of required provisions based on each classification category. In many countries, in particular those with fragile economies, regulators have established mandatory levels of provision, which are related to assets classification.

The established level of mandatory provisions is normally determined by certain statistics in countries where the legal framework for debt recovery is highly developed, such as the United State studies have demonstrated that approximately 10 percent of substandard assets eventually deteriorate into loss. The percentage for doubtful and loss classifications are approximately 50 percent and 100 percent respectively. In developing countries where the legal framework and traditions for debt collection may be less effective provisions in the range of 20 to 25 percent of substandard assets may be a more realistic estimate of loss potential. In evaluation, the level of provisions established by a bank, an analysis must clearly understand whether the bank is aggressively writing off its losses or is simply providing for them. The approach used in a particular country often depends on the taxation applied to provision by the fiscal authorities. In the assessment of credit risk management regulators use the non- performing loans (NPLs) accounts of its bank due to the rule and regulation of Central Bank of Myanmar (CBM). According to the recently conducting policies, specific provision for NPL accounts are as follow.

1. Watch Loan- Overdue 31 days to 60 days of default and specific Provision is 5% on security short fall amount.
2. Substandard loan- Overdue 61 days to 90 days of default and specific Provision is 25% on security short fall amount.

3. Doubtful loan- Overdue 91 days to 180 days of of default and specific Provision is 50% on security short fall amount.
4. Loss loan - Overdue more than 180 days of default and specific Provision is 100% on security short fall amount.

2.3 Factors Causing Credit Risk

According to Taxmann's (2004), some of the important factors which cause credit risk and have adverse impact on credit quality, highlighted in various studies conducted by expert committees/groups are listed under:

1) Deficiencies in appraisal of loan proposals and in assessment of creditworthiness/ financial strength of borrowers.
2) Inadequately defined lending policies and procedures.
3) High prudential exposure limits for individual and group of borrowers.
4) Absence of credit concentration limits for various industries/business segments.
5) Inadequate value of collaterals obtained by the banks to secure the loan facilities.
6) Over optimistic assessment of thrust/potential areas of credit.
7) Liberal loan sanctioning powers for bank executives without checks and balances.
8) Liberal sanctioning of non-fund-based limits without proper scrutiny of borrowers' activity, financial strength, cash flows etc.
9) Lack of knowledge and skills of officials processing loan proposal and subjectivity in credit decisions.
10) Lack of effective monitoring and consistent approach towards early recognition of problem accounts and initiation of timely remedial actions.
11) Lack of proper coordination between various departments of bans looking into credit functions.
12) Lack of well-defined organizational structure and clarity regarding responsibilities, authorities and communication channels.
13) Lack of proper system of credit risk rating, quantifying and managing across geographical and product lines.

14) Lack of effectiveness of existing credit inspection and audit system in banks and slow progress in removal of the deficiencies as revealed in inspection/audit of branches and controlling offices.
15) Lack of reliability and integrity of data being used for managing credit and risks associated with lending.
16) Banks have been harping too much on staff accountability as a result demotivating the staff and not looking at the credit decisions from hindsight.

The above listed factors which are illustrative in nature may have adverse impact on quality of credit portfolio can be remedied only if the bank has evolved efficient credit administration and risk management systems which may include formulation of well-articulated polices/procedures, creating and effective organizational structure manned by well trained and committed personal ect.

2.4 Principles for the Management of Credit Risk set by Basel Committee

While financial institutions have faced difficulties over the years for a multitude of reasons, the major cause of serious banking problems continues to be directly related to lax credit standards for borrowers and counterparties, poor portfolio risk management, or a lack of attention to changes in economic or other circumstances that can lead to a deterioration in the credit standing of a bank's counterparties. This experience is common in countries.

Since exposure to credit risk continues to be the leading source of problems in banks world-wide, banks and their supervisors should be able to draw useful lessons from past experiences. Banks should have a keen awareness of the need to identify, measure, monitor and control credit risk as well as to determine that they hold adequate capital against these risks and that they are adequately compensated for risks incurred. The Basel Committee issued principles for the management of credit risk on September 2000 in order to encourage banking supervisors globally to promote sound practices for managing credit risk.

According to Basel Committee, the credit risk is caused mainly due to weakness in credit administration and risk management functions more specifically related to lack of proper pre-sanction appraisal and credit granting process adverse credit distribution and concentration, ineffective loan monitoring and audit functions, delayed identification and initiation of remedial action in problem exposures; inadequate credit policy, ect.

The sound practices set out in Basel document specifically address the following areas: (A) establishing an appropriate credit risk environment; (B) operating under a sound credit-granting process; (C) maintaining an appropriate credit administration, measurement and monitoring process; and (D) ensuring adequate controls over credit risk. Although specific credit risk management practices may differ among banks depending upon the nature and complexity of credit activities, a comprehensive credit risk management program addressed these four areas. These practices are also applied in conjunction with sound practices related to the assessment of asset quality, the adequacy of provisions and reserves, and the disclosure of credit risk.

A. Establishing an Appropriate Credit Risk Environment

Principle 1: The board of directors should have responsibility for approving and periodically (at least annually) reviewing the credit risk strategy and significant credit risk policies of the bank. The strategy should reflect the bank's tolerance for risk and the level of profitability the bank expects to achieve for incurring various credit risks.

Principle 2: Senior management should have responsibility for implementing the credit risk strategy approved by the board of directors and for developing policies and procedures for identifying, measuring, monitoring and controlling credit risk. Such policies and procedures should address credit risk in all of the bank's activities and at both the individual credit and portfolio levels.

Principle 3: Banks should identify and manage credit risk inherent in all products and activities. Banks should ensure that the risks of products and activities new to them are subject to adequate risk management procedures and controls before being introduced or undertaken and approved in advance by the board of directors or its appropriate committee.

B. Operating under a Sound Credit Granting Process

Principle 4: Banks must operate within sound, well-defined credit-granting criteria. These criteria should include a clear indication of the bank's target market and a thorough understanding of the borrower or counterparty, as well as the purpose and structure of the credit, and its source of repayment.

Principle 5: Banks should establish overall credit limits at the level of individual borrowers and counterparties, and groups of connected counterparties that aggregate in a comparable and meaningful manner different types of exposures, both in the banking and trading book and on and off the balance sheet.

Principle 6: Banks should have a clearly-established process in place for approving new credits as well as the amendment, renewal and re-financing of existing credits.

Principle 7: All extensions of credit must be made on an arm's-length basis. In particular, credits to related companies and individuals must be authorised on an exception basis, monitored with particular care and other appropriate steps taken to control or mitigate the risks of non-arm's length lending.

C. Maintaining an Appropriate Credit Administration, Measurement and Monitoring process

Principle 8: Banks should have in place a system for the ongoing administration of their various credit risk-bearing portfolios.

Principle 9: Banks must have in place a system for monitoring the condition of individual credits, including determining the adequacy of provisions and reserves.

Principle 10: Banks are encouraged to develop and utilise an internal risk rating system in managing credit risk. The rating system should be consistent with the nature, size and complexity of a bank's activities.

Principle 11: Banks must have information systems and analytical techniques that enable management to measure the credit risk inherent in all on- and off-balance sheet activities. The management information system should provide adequate information on the composition of the credit portfolio, including identification of any concentrations of risk.

Principle 12: Banks must have in place a system for monitoring the overall composition and quality of the credit portfolio.

Principle 13: Banks should take into consideration potential future changes in economic conditions when assessing individual credits and their credit portfolios, and should assess their credit risk exposures under stressful conditions.

D. Ensuring Adequate Controls over Credit Risk

Principle 14: Banks must establish a system of independent, ongoing assessment of the bank's credit risk management processes and the results of such reviews should be communicated directly to the board of directors and senior management.

Principle 15: Banks must ensure that the credit-granting function is being properly managed and that credit exposures are within levels consistent with prudential standards and internal limits. Banks should establish and enforce internal controls and other practices to ensure that exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action.

Principle 16: Banks must have a system in place for early remedial action on deteriorating credits, managing problem credits and similar workout situations.

CHAPTER 3

CREDIT RISK MANAGEMENT PRACTICES IN UAB

In this chapter, Profile of UAB, Mission and value of UAB, Organizational structure of UAB, UAB credit risk management policies, Credit risk management process and procedure of UAB, Loan monitoring and loan recovery action of UAB are presented.

3.1 Profile of UAB

UAB Bank Limited is a Private Bank Limited established in Myanmar and has its registered office at Bank Development Zone, No.3, Corner of Kyaing Tone Road and Mawlamying Road, Oaktaya Thiri Township, Nay Pyi Taw. The Directorate of Investment and Company Administration (DICA) has issued incorporation certificate to UAB Bank Limited on 14 June 2010 as per Registration No.390/2010-2011 under The Myanmar Companies Act. The Bank has extended it's incorporation certificate on 25 May 2015 valid five years through 13 June 2020. The Bank is allowed to carry out banking business under License No. MaVaBa/PaBa(R) 14/8/2016 issued by the Central Bank of Myanmar (CBM) on 24 August 2016 under Section 14(A) of Financial Institutions of Myanmar Law (2016). The principal activities of the Bank are to carry out the domestic banking business and other banking services subject to the approval of the CBM. On 25 November 2011 the bank obtained an Authorized Dealer Licence No. CBM, FE MD (78/2011) to carry out banking business in both local and foreign currencies. The Bank is presently operating with Seventy-Seven (77) branches in total in wide spread locations in Myanmar.

Mission of UAB is to lead the way towards a better Myanmar, humanising banking, connecting people, creating opportunities and changing lives. It’s Vaule is “Connect. Create. Change.”

A desire to connect: UAB believes in the power of building strong and meaningful relationships, connecting with fellow UABians, its customers and the community it is in. UAB strive for success that is inclusive through teamwork and collaboration, valuing each other’s contribution and opinions.

A passion to create: UAB values creativity that constantly seek practical ways to bring improvements, solve problems and simplify banking. It looks to innovate and redefine banking in Myanmar, generating new ideas and opportunities for the market and it's customers.

The courage to lead change: UAB has the courage to lead change, recognising that change is disruptive yet necessary. UAB wants people who will stand up to their ideas, look forward to the future and challenge the present. It believes in a performance driven culture, yet always having in mind the importance of integrity, stewardship and building a sustainable future for Myanmar people and Myanmar country.

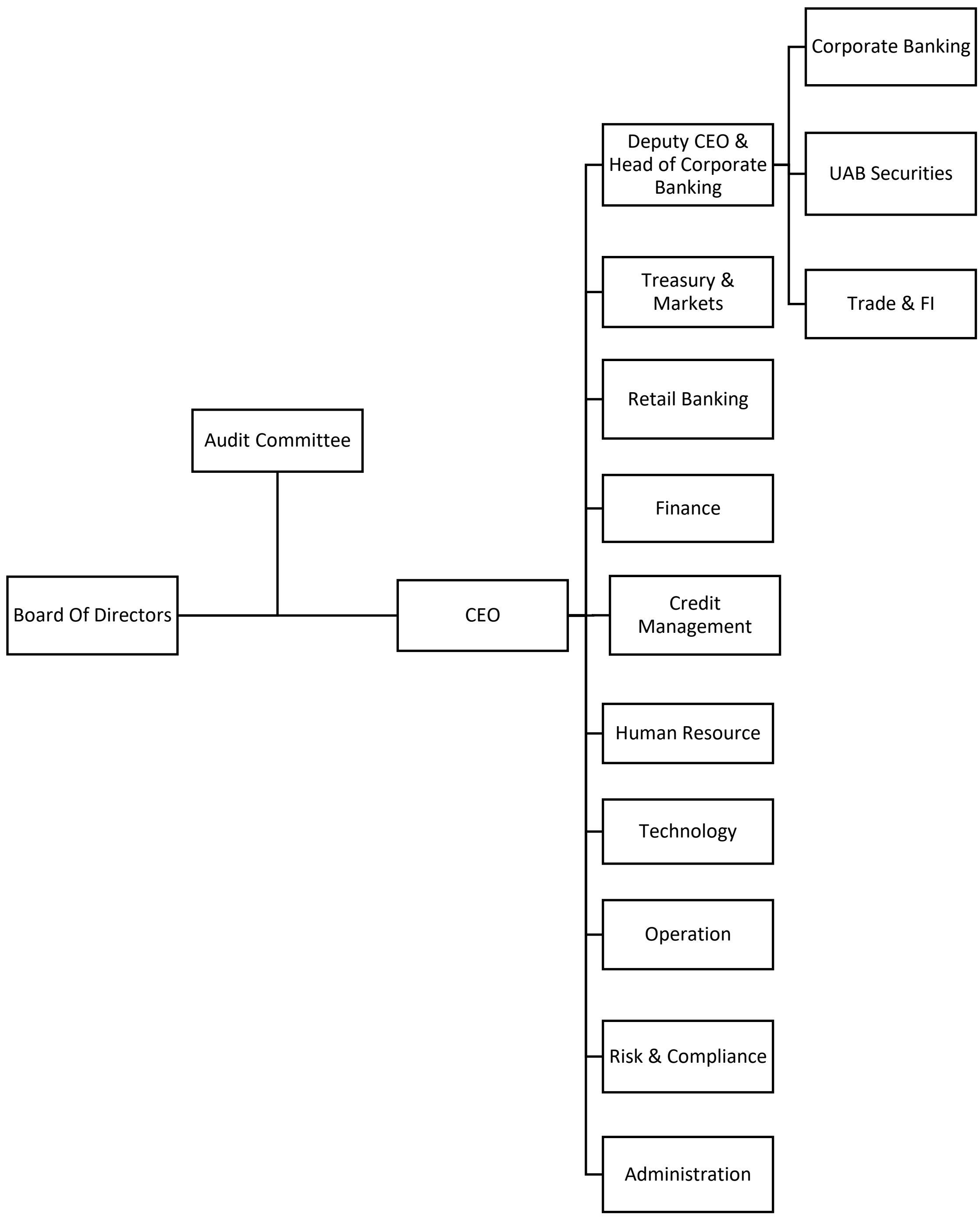
Above all, UAB's values embody its commitment towards "Leading Change and Humanising Banking"

3.2 Organizational Structure of UAB

UAB Bank has a proper organization structure, which is stated below. Board of Directors sits on the very top of the organization chart and directly handle Audit Department with the support of Chief Executive Officer (CEO). CEO is supported by Dy.CEO and Head of various Departments. Dy.CEO is mainly responsible for Trade finance department, Corporate Banking department and Investment Banking department. Treasury & Market department,

Retail Banking department, Credit Management department, Human Resource department, Technology department, Risk and Compliance department, Administration department, Operation department and Legal & Secretariat department are directly handle by CEO. The organization chart of UAB Bank is as shown in figure (3.1).

Figure 3.1 Organization chart of UAB



Source: UAB Bank, 2019

3.3 Credit Risk Management of UAB

In UAB, Credit Risk Governance and oversight is conducted by the Management Credit Committee and Board Credit Committee.

Board Responsibility

The Board of Directors (‘the Board”) is cognizant of its overall responsibility in the establishment of a sound credit risk management and internal control system as well as reviewing its adequacy and effectiveness. The Board has established the following mechanism to ensure that the risks are managed within the tolerance level set to achieve the Bank’s business objectives:

1) Set overall risks appetite and ensure that mechanisms are in place to effectively mitigate risk.
2) Ensure appropriate policies, procedures and controls are in place to manage such risks; and
3) Ensure that arrangements are in place for the effective reporting on all issues related to the functioning of the credit risk management system.

Senior Management Responsibility

The management is responsible for implementing the Board’s policies and procedures to manage risks in accordance to the risk appetite set. Their roles include:

1) Identify and evaluate risks relevant to the Bank’s business, and the achievement of its business objectives
2) Formulate and implement policies and procedures to manage these risks, as approved by the Board
3) Design, implement and monitor the effective implementation of risk management and internal control system
4) Report in a timely manner to the Board any changes to the risks and the corrective actions taken

UAB has established following policies related to credit risk management.

1. **Single / Group Lending Exposures:** Shall not lend more than 20 % of their capital funds plus reserves to a single individual, an enterprise, or an economic

group, and none of their 10 largest debtors , including economic groups , shall account for more than 30% of their total loan portfolio.

(Sec 32 : Financial institutions Law)

2. **Large Exposure Limit:** The aggregate of all large exposure (more than 10% of core capital) of a bank shall not exceed 8 times of its core capital. (As per CBM instruction)

4. **Mortgage on Landed Properties**: Loan amount should not exceed 80% of forced sale value on Land 50% of forced sale value on building.

5. **Types of Acceptable Collaterals:** Lease hold land, Free hold land, La Na 39, goods, machinery

6. **Margin of Cost of Goods Pledged to Avail Pledge Loan**: Loan amount should not exceed 60% of pledged goods.

7. **Liquidity Ratio:** to maintain a minimum liquidity ratio of 20 at all times

8. **Period of Loan:** All of loan types are short-term loans (repayable not more than one year) as Central Bank of Myanmar Instruction. When the one year is completed, however the borrowers must repay the loan, he can demand to extend the term next year.

9. **Loan Loss Provision Policy:** The bank performs to absolutely eliminate the credit risk by removal the provision reserves from annual income to obtain the adequate protection. The bank remains the 2% of loan outstanding amount existed at the end date of budget year from annual net incomes as provision for loan loss reserve and remain the certain amount of net incomes approved by board of directors as provision for bad and doubtful debt. IT is the duty of loan recovery department.

UAB has established credit policies and processes to manage credit risk in the following key areas:

a. credit approval process
b. the credit origination and approval functions are clearly segregated
c. credit approval authority is delegated to officers based on their experience, seniority and track record

d. credit approval is based on the borrower's credit rating based on a credit rating system
e. credit policies and credit guidelines that are periodically reviewed to ensure their continued relevance to the Bank's business strategy and business environment.
f. credit concentration risk arising from a single party large exposure or from multiple exposures that are closely related. This is managed by setting exposure limits on obligors, portfolios, borrowers, industries and geographical areas.
g. credit monitoring and remedial management with the Bank regularly monitoring credit exposures, portfolio performance and emerging risks that may impact its credit risk profile. The Board and senior management are updated on credit trends through internal risk reports.
h. delinquency monitoring is closely monitored since the delinquency of borrowing accounts is a key indicator of credit quality. An account is considered as delinquent when payment is not received on due date. Any delinquent accounts, including a revolving credit facility (such as an overdraft) with limit excesses, is closely monitored and managed through a disciplined process by officers from business units and risk management function. Where appropriate, such accounts are also subject to more frequent credit reviews.
i. classification of loans are made in compliance to the guidelines from the Central Bank of Myanmar. Performing loans are classified against their Credit ratings and categorized under "Standard", "Watch" and "Substandard" whilst non-performing loans are categorized as 'Doubtful' or 'Loss' in accordance with the Bank's Policy. Any account which is delinquent (or in excess for a revolving credit facility such as an overdraft) for more than 90 days will be categorized automatically as 'Non-Performing'.

The strategy for managing credit risk in the Bank is anchored on the three lines of defense concept which are as follows:

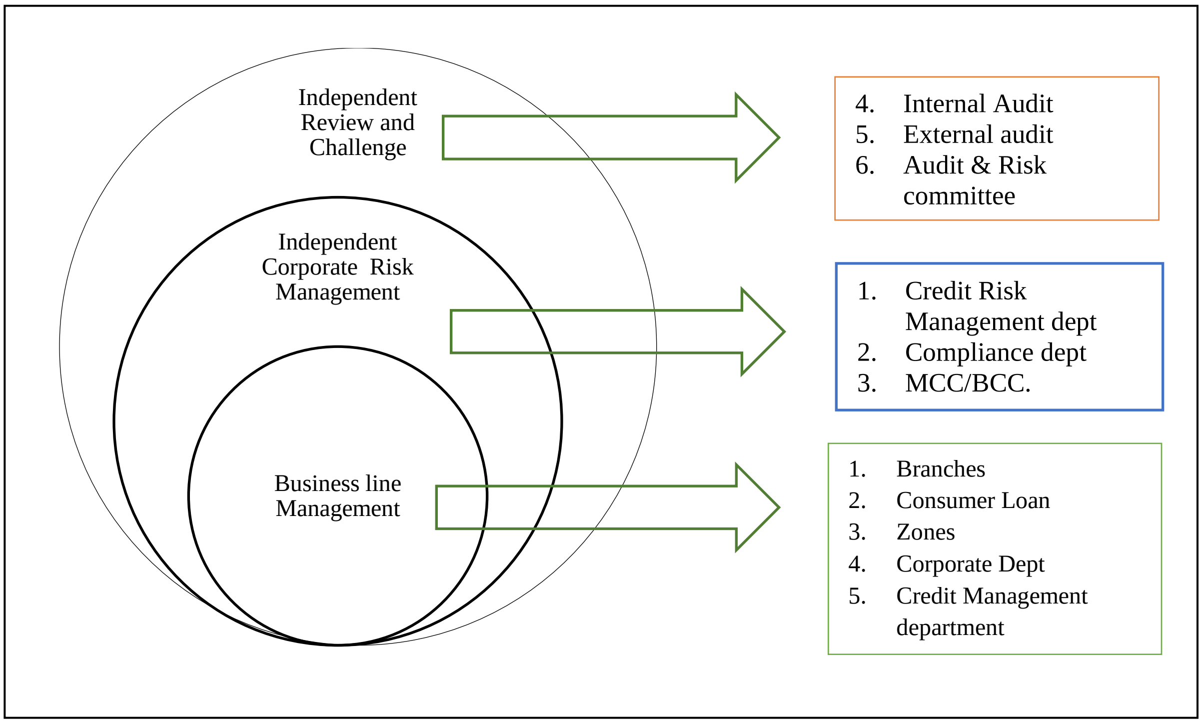
1st Line of Defense: Branches, Consumer Loan department, Zones, Corporate Banking department and Credit Management department who own and manage risk as part of their day-to-day activity

2nd Line of Defense: Independent risk functions including Credit Risk Management department, Compliance Department, Management Credit Committee and other functions overseeing risks.

3rd Line of Defense: Internal audit, external audit and other 3rd party specialists who provide independent assurance.

Several risk mitigation policies are in place to maintain a sound operating environment. This includes identifying the source of risk which may include People, Policy, Processes Procedure or Platform & systems.

Figure 3.2 Three Lines of Defense in Credit Risk Management of UAB



Source: UAB Bank, 2019

3.4 Credit Risk Management Process and Procedure of UAB

Credit management process and procedure of UAB consists of Interview with the borrower, Field visits and enquiry about the borrower, List of documents required for a credit proposal, Presentation to credit committee and BOD.

1. Credit Proposal: A credit proposal refers to an orderly set of written reports with respect to the party applying for credit facilities, culminating in a recommended course of action for decision by the approving authority. It is the product of credit analysis, which encompasses a range of analysis and judgment regarding every area of the party or applicant's business activities. In view of the serious consequences or repercussions that could occur as a result of inadequate or careless analysis on the part of the lending officers, therefore credit officers emphasize the importance of careful and thorough credit analysis.

2. Interview with the Borrower: It is important that the bank should ask details and collect all information regarding the business. UAB credit officers well understand, which questions should be asked to whom. They ensured that the customers are not offended by their questions and the officers try to make the customer understand, the need of such an interview with a loan customer to process with the Loan request. And record all the financial and business details of the customers, in the loan proposals as per internal guidelines of the bank, guidelines issue d by the Central bank etc.

After conducting the interview with the customer and making local enquiry about the customer, Branch Manager and Credit officer take a decision, whether they should process the customer request or not. If they decide to proceed with the customer request, they collect all the required documents, application forms and inform the customer that bank wish to proceed with the proposal and give the list of documents required by the bank to process the loan application.

4. Field Visits and Enquiry about the Borrower: Branch Manager and Credit officer visit customer's business place, collateral security properties, residence, factory, ware house, etc and assess the realities on ground and match with the information given by the customer during interview and details provided in the documents submitted by them. During the preparation of the credit proposal, concerned officer enquire about the customer and guarantors to known persons, persons doing the same line of business, without divulging the fact that the customer applied for credit facility with the bank.

5. List of Documents Required for a Credit Proposal: Documents are required to be submitted by the customer for assessment of eligibility and prepare credit proposal. The required documents are duly filled loan application form from the customer, address proof and photo of all the borrowers, partners and guarantors, copies of NRC, copies of census, recommandation letter of chief of quarter for stay in the house, certificate of incorporation and commencement of business, company documents (if borrower is company), last two years audited balance sheet, last 12 months bank statement (If the customer is banking with other banks) and copies of past and existing contracts, Licenses, permits, copy of approval from local authorities for construction, approved plan (if the purpose is for construction), copy of performs invoice/ quotation etc(if the purpose of finance is to buy machinery), vehicles, or other fixed assets, copies of all the documents related to collateral security property such as grant documention reative to land possession, register document and other relative document, land map, land history, form 105,106 which must be taken within six months, building photo (front, back, sides, inside, floor by floor), legal opinion from the lawyer about the security property and, photos of business places, shops, warehouse , etc.

6. Reports of Lawyer and Assessor: The lawyer and the assessor assigned by the bank submit their respective reports after performing their tasks. The reports usually contain as mentioned below; The Lawyer's report includes particulars of immovable properties used as collateral, history of holdings, clearance of ownership, and the names of persons who shall sign in the deed of mortgage also called on demand. The assessor needs to perform his tasks only when the lawyer recommends the ownership of the property (mortgage) as clear title. The assessor's report includes particulars of immovable properties used as collateral but must be the same as those mentioned in the lawyer's Report. It also describes the feature of the property in detail. The property is assessed in market values as well as forced sale value. Loan amount is decided by the credit committee base on the forced Sale value of the property (collateral).

7. Submitting to Approving Authority and Getting Approval: After completing all the process of documents collection, verification, local enquiries, collateral valuation, credit risk rating etc, credit officer and branch manager prepare the credit proposal communicated by head office. After finalizing the credit proposal, a printout is taken and signed by the credit officer and branch manager and send to head office.

Up on completion of presentation, file is presented to relevant approving authority. After getting approval from authority, credit department prepare loan approval letter to branches in the standard format and add all the terms and conditions applicable to the credit facility approved. When branch receives approval letter from head office, branch manager and loan officer arrange to disburse the loan after getting loan documentations.

8. Insurance Cover: After the loan agreement is made, the mortgage like building and machinery are insured against fire at the insurance companies. The premium on the insurance policy is paid by the borrower, though the name of insured is the bank. The value of the policy is usually amounted to 125 percent of the total loan for mortgage. Like first class buildings and houses, and 150 percent of total loan for other buildings in normal condition.

3.4.1 Loan Monitoring

An account is put under surveillance by the bank and monitored when the following events occur:

1) Bad or deteriorating financials
2) Litigation against Borrower
3) Key principal of borrowing customer dies or becomes incapacitated
4) Collateral security value significantly decreased as detected during account review.
5) Excesses – regular and exhibiting further deterioration.
6) Installment Loan repayments habitually in arrears.
7) Overdrafts becoming hardcore.
8) Where Directors, Partners or Partners or proprietor’s personal accounts (E.g. cards, mortgages, loans etc) are delinquent.
9) Delayed provision of financial statements or other mandated and relevant information.
10) Material breach of covenant without satisfactory response from Borrower.

After having a clear understanding of the problems, appropriate remedial measures are taken which includes continue with close monitoring, re-schedule debt, restructure debt and recall the debt.

3.4.2 Loan Recovery Action

Despite the rescheduling or restructuring being carried out and if the loans still cannot be regularized and continue to be in delinquent status, serious considerations are taken to recall the facilities and recover the full outstanding owing to the Bank. The recovery action includes: the recall of credit facilities, the realization of security held through the legal process which includes auction sales and suit against the Guarantors, if any.

CHAPTER 4

COMPLIANCE OF BASEL CREDIT RISK MANAGEMENT PRINCIPLES IN UAB

This chapter includes the analysis of compliance status of Basel credit risk management principles in UAB.

As per Basel Credit Risk Management Principles, there are seventeen principles which are combined in four major topics; 1) Establishing an appropriate credit risk environment 2) Operating under a sound credit granting process 3)Maintaining an appropriate credit administration, measurement and monitoring process 4)Ensuring adequate controls over credit risk.

4.1 Establishing an Appropriate Credit Risk Environment

There are 3 principles under this topic and mainly guided for setting policies and implementing policies and roles of BOD and Management. In UAB, roles of BOD and roles of Management is clearly defined as per Basel guidance. BOD sets strategy and policies in accordance with bank targeted achievement and expected level of profit. Management takes responsible to implement the policies and establishes the required process and procedures for implementing the policies. Credit risk is managed by three lines of defenses. Branches, Consumer Loan department, Zones, Corporate Banking department and Credit Management department are playing as first line of defense in their day to day credit functions. Credit Risk Management department, Compliance Department, Management Credit Committee are second line of defense by conducting Independent credit risk functions and Internal audit, external audit are playing as third line of defense to ensure the compliance of credit risk management policies set by BOD and regulatory bodies. Hence, UAB credit risk management practices are complied with Basel principles topic no.1.

4.2 Operating under a Sound Credit Granting Process

There are 4 principles under this topic and mainly guided for setting overall and individuals limits and granting of new and renew loan. In UAB, loan limits are set in both portfolio level and individual level. New loans are granted after making proper assessment such us interviewing with credit applicant, making market enquiry about credit applicant, collecting required documents for proper assessment, getting legal opinion on clearance of collateral documents’ title, getting independent assessor value on collateral, submitting credit proposal to relevant approving authority, issuing credit approval, executing loan documents with borrower and monitoring of credit. Individual credits are reviewed annually. Delegation of lending authority is given to Branch Managers, Director of Credit Management Department, Deputy CEO, CEO, Management Credit Committee and Board Credit Committee.

Concentration risk in banks credit portfolios either arises from an excessive exposure to certain names or from an excessive exposure to a single sector or to several highly correlated sectors. Since 2014 onwards, UAB established targets for portfolio mix as well as set exposure spread by by industries, spread by business segment, spread by geographic regions, limits on single counterparty or group of connected parties etc to reduce concentration risk to any sector. Followings are the data analysis of UAB loan portfolio by sectors, segments, geographical areas and exposure ceilings. Three financial years from 2016-2017 to 2018-2019 are analsed for better understanding of loan portfolio.

Loan Portfolio by Industries

Industry Sectors Exposure Ceilings indicate maximum exposure to a particular Sector of economy of the country. The sectors are classified as bank’s risk appetite level and international practices. In UAB, industry are classified International Standard Industries Classification (ISIC). The indicative classification of industries and UAB loan exposure % on individual industry are as shown in table (4.1) and maximum ceiling for each industry is defined not to go more than 20% of total loans.

Table 4.1 Loan Disbursement % by Industries in UAB

Industries	2016-2017	2017-2018	2018-2019	UAB Ceiling
Agriculture, forestry and fishing	0.2	1.0	1.0	20
Mining and quarrying	1.2	1.2	1.4	20
Manufacturing	7.3	7.6	6.9	20
Electricity, gas, steam and air conditioning supply	-	-	-	20
Water supply; sewerage, waste management and remediation	-	-	-	20
Construction	2.9	6.2	6.2	20
Wholesale and retail trade	42.8	41.0	41.9	20
Transportation and storage	0.3	0.5	0.4	20
Accommodation and food service activities	8.9	10.1	9.7	20
Information and communication	0.0	3.7	3.6	20
Financial and insurance activities	0.0	0.0	0.0	20
Real estate activities	19.9	18.7	16.8	20
Professional, scientific and technical activities	-	0.5	0.5	20
Administrative and support service activities	-	0.5	2.0	20
Public administration and defence; compulsory social security	-	-	-	20
Education	8.8	1.0	1.0	20
Human health and social work activities	-	0.2	0.2	20
Arts, entertainment and recreation	-	0.2	0.2	20
Other service activities	-	2.7	2.7	20
Activities of households as employers; undifferentiated goods- and services- producing activities of households for own use	-	-	-	20
Activities of extraterritorial organizations and bodies	-	-	-	20
Interbank Lending	5.7	3.1	3.6	20
Others (Personl loans, HP, Credit Cards, etc)	2.0	1.7	2.0	20

Source: UAB Credit Policy Manual & UAB annual report, September 2019

According to table (4.1), concentration on loans to wholesale and retail trade is over 40% of total loan portfolio and it is above ceiling of 20%. Exposure to other industries are within ceiling. Since most of the business units in Myanmar are trading in current situation, lending to trading industries is more than other industries in banks. However, UAB should more emphasize to lend to other sectors to bring down the portion of wholesale and retail trade sector for better diversification of loan portfolio.

Loan Portfolio by Business Segments

Another aspect of concentration risk is the business segment. There are four business segments defined in UAB. They are Corporate loan, Enterprise loan, SME loan and Consumer loan. The definition of each business segment are as follow.

Corporate Loans: Credit facilities approved to following category of business units are classified as Corporate Loans.

1) Public companies and/or listed companies
2) Subsidiaries of listed companies
3) Subsidiaries of the existing corporate customers
4) Revenue above 25bn MMK of which their financial statements are prepared by top rated International Audit Firms (e.g: PWC, KPMG, E&Y).
5) Designated accounts to be determined by Dy CEO and CEO.

Enterprise Loans: Credit facilities approved to following category of business units are classified as Enterprise Loans.

1) Manufacturing & Labor-intensive units - Total facility above MMK 1000 Mn
2) Other business units (Wholesale, Retail, Service & Other businesses) - Total facility above MMK 500 Mn.

SME Loans: Credit facilities approved to following category of business units are classified as SME Loans.

1) Manufacturing & Labor-intensive units –- Total facility MMK 1000 Mn and below
2) Other SME units (Wholesale, Retail, Service & Other businesses) - Total facility up to and including MMK 500 Mn.

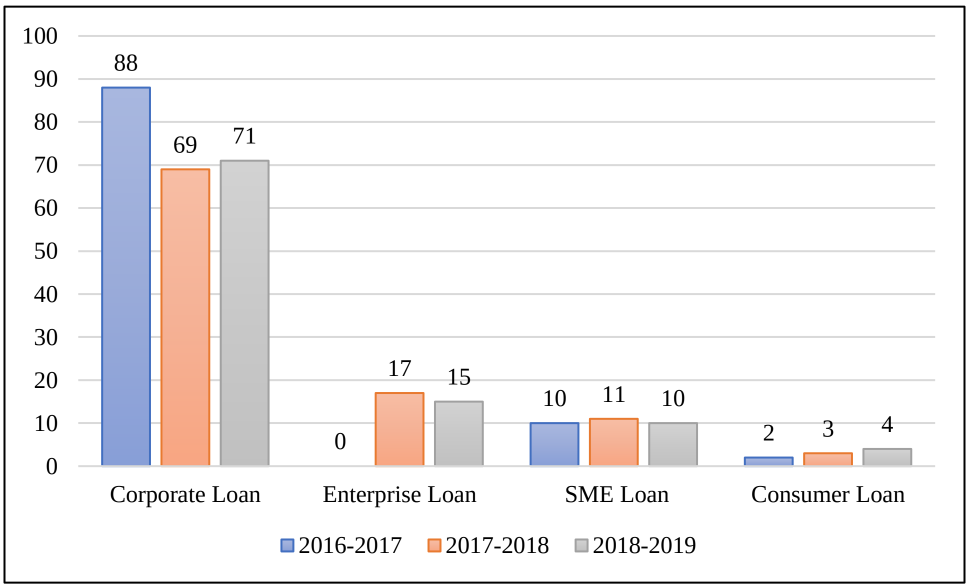
Consumer Loans: Credit facilities approved to individuals for personal purposes such as Home Loans, Auto Loans, Hire Purchase Loans, Educational Loans, Mortgage Loans, Salary Loans, and Credit Cards etc are classified as Consumer Loans. The targeted percentage for individual segment and actual achievement within three financial years are shown in table (4.2)

Table 4.2 Loan Disbursement % by in UAB

Segment	2016-2017	2017-2018	2018-2019	UAB Ceiling
Corporate Loan	88	69	71	60
Enterprise Loan	0	17	15	17
SME Loan	10	11	10	15
Consumer Loan	2	3	4	8

Source: UAB Credit Policy Manual and UAB annual report, September 2019

Figure 4.1 Loan Disbursement % by in UAB



Source: UAB annual report, September 2019

As per table (4.2) and figure (4.1), corporate loans are given maximum weighted as 60% of total loan portfolio, Enterprise loans and SME loans are given medium and consumer loans are given minimum weighed in UAB. Loans to corporate segment are above ceiling of 60% of total loan portfolio. However, it has reduced over the years. In 2016-2017, it was 88% of total loan portfolio and it has reduced to 71% in 2018-2019. Other sectors are within targeted ceilings. As UAB introducing SME loans and more consumer loans such as home loan and auto loans during 2019, those loans will improve as per target and corporate loan is expected to come down within ceiling in next year.

Loan Portfolio by Geographical Areas

In UAB, geographical exposure is defined by three areas which are Yangon, Mandalay and other areas. The maximum ceiling by geographical area and actual achievement within three financial years are illustrated in table (4.3).

Table 4.3 Loan Disbursement % by Geographical Area in UAB

Geographical area	2016-2017	2017-2018	2018-2019	UAB Ceiling
Yangon	80.50	84.94	88.35	75
Mandalay	18.98	14.60	10.49	23
Other Area	0.52	0.46	1.16	2

Source: UAB Credit Policy Manual and UAB annual report, 2019

According to table (4.3), Loans disbursed in Yangon region constitutes almost 80% to 90% of total loan. As Yangon is the major center for business, most of the loan customers of UAB are from Yangon. However, this situation is not good as geographical risk is high. In case of natural calamities affecting Yangon, UAB's credit risk will be high. In current year, UAB has plans to extend loans to other regions.

Large Exposure Ceiling

Based on Basel standard, CBM has issued "Large exposure Regulation" on 07-07-2017 with the reference instruction No.18/2017. As per that regulation, the definition and maximum ceiling for large exposure is as follow.

"Large exposure" is a financial exposure to a person or counterparty or group of connected counterparties which in the aggregate equal or exceed 10 of core capital of the bank. The aggregate of all large exposure of a bank shall not exceed 8 times of its core capital."

UAB's large exposure position for three financial years is shown in in table (4.4).

Table 4.4 Large Exposure position in UAB

Large Exposure	2016-2017	2017-2018	2018-2019
Times of Core Capital	8.24	6.13	5.04

Source: UAB annual report, 2019

According to the table (4.4), UAB large exposure is 8.24% of 8 times of core capital in year 2016-2017 but it has reduced to 6.13% in year 2017-2018 and further reduced to 5.04% in 2018-2019. Even though, it was above the regulatory ratio in 2016-2017 financial year, UAB could reduce to come down within regulatory requirement and it is fully complied with large exposure regulation stipulated by CBM.

Liquidity Ratio

Banks monitor and manage the sources of funding for the credit portfolio to ensure the bank is not unnecessary exposed to liquidity risk in situation of tight liquidity market scenario. As per Basel standard, CBM regulated that "banks to maintain a minimum liquidity ratio of 20 at all times" with the instruction no.19/2017 dated 07-07-2017 and UAB is following the same as per Basel and CBM guidelines. UAB's liquidity position three financial years is shown in in table (4.5).

Table 4.5 Liquidity position in UAB

	2016-2017	2017-2018	2018-2019
Liquidity Ratio (%)	32.1	33.1	28.8

Source: UAB annual report, 2019

According to the table (4.5), UAB's liquidity ratio is 32.1%, 33.15 and 28.8% in 2016-2017, 2017-2018 and 2018-2019 respectively. UAB could maintain the minimum liquidity ratio requirement in every year and it is compiled within CBM's stipulated ratio of 20%.

According to the above data, UAB has diversified the loan portfolio in various segments and topic no.2 of Basel principles is complied.

4.3 Maintaining an Appropriate Credit Administration, Measurement and Monitoring Process

This topic includes six principles and mainly guided for monitoring the condition of individuals credit and quality of portfolio and to develop internal credit rating system. In UAB, loan portfolio is reviewed regularly, and the Bank continuously monitors the operating environment to identify emerging risks and to formulate mitigating actions. Credit Risk Governance and oversight is conducted by the Management Credit Committee and Board Credit Committee. The Credit Management Department is responsible for the reporting, analysis and management of all elements of credit risk.

Credit Rating of UAB

As per international best practices and Basel principles, each borrower should be rated according to the risk of lending to the customer and a credit risk rating should be given. UAB bank has prepared their own risk models as per bank's internal policies, to rate their customers and given different ratings.

1.Customer Rating: In UAB credit rating model, customer is rated based on15 parameters which are length of business started, Promoters, business continuity, Type of business, business sector, management quality, previous banking experience, availability of goods, business performance, Profitability of business, Purpose of finance, quality of information and transparency, diversification of business, type of major facility, value to UAB – expected and total marks is given 100 marks. Final rating models are allotted as based on percentage of marks. Customer rating is defined as UABC. Marks obtained above 80% is rated at UABC-1, between 80% to 70% is UABC-2, between 70 % to 60% is UABC-3, between 60% to 50% is UABC-4 and under 50% is UABC-5. When the customer has highest rating, bank considers the customer request with more relaxed terms and conditions. When a customer has rated lower in the initial rating done by branches, they try to analyze, where the customer has lost marks and try to improve such areas, by discussing with customer and asking for more details, cross selling the products, getting other bank account details, etc.

2. Collateral Rating: Securities offered by the customer is rated based on three parameters which are primary security, collateral security and guarantee. Marks are allocated based on its value, location, easy marketability, legal status, personal/ corporate guarantees etc and total is 50 marks. Rating is given the percentage of total marks. Collateral Rating is defined as UABS. Marks obtained above 80% is rated at UABS-1, between 80% to 70% is UABS-2, between 70% to 60% is UABS-3, between 60% to 50% is UABS-4 and under 50% is UABS-5. If the customer is top rated, even though collateral rating is lower, banks take a positive view on the customer request considering the value of the customer. In case of lesser collateral securities, branch try to get additional securities by way of hypothecation of stocks and machineries, additional personal guarantees and corporate guarantees etc and try to get better ratings security is rated as follows based on percentage of marks obtained.

3. Over All Rating: Based on percentage of total marks received by the customer as per separate customer rating and collateral rating, final rating models are awarded. Over all rating is defined as UAB. Marks obtained above 80% is rated at UAB-1, between 80% to 70% is UAB-2, between 70 % to 60% is UAB-3, between 60% to 50% is UAB-4 and under 50% is UAB-5. Normally if customer is rated UAB-4 and UAB-5, their loan requested will not be considered. (See in appendix)

As per rating analysis, more than 95 of loan customers are rated UAB-1 to UAB-3. Rating system introduced in 2015 in UAB and it can choose the loan customers effectively and eligible loan amount also can decide easily. Hence UAB credit risk management is complied with topic no.3 of Basel principles.

4.4 Ensuring Adequate Controls over Credit Risk

There are 3 principles under this topic and mainly guided for independent monitoring of credit process and procedures and early remedial action. In UAB, internal audit is conducted periodically to ensure that credit policies and procedures are complied, and credit exposures are generally within prudential limits. The Bank has a well-established internal audit function which reports functionally to the Board Audit Committee and administratively to the CEO. It operates within the Internal Audit Framework and is guided by The Internal Audit Function in Banks issued by the Basel

Committee on Banking Supervision. External Audit and CBM audit also conducted auditing yearly to ensure the independent monitoring of credit process and procedures.

Asset Classification and Provisioning

As per Basel principle, banks must have in place a system for determining the adequacy of provisions and reserves. CBM regulated that "A bank shall make adequate provisions for impairment of loans, advances and other assets on and off-balance sheet whenever the impairment occurs. The specific provisions for the impairment is to be made against all outstanding balance (principle and interest) of the loans and advances, not just the past due portion."

There are two types of provisions on loans and advances. They are specific provision and general provision. Specific Provisions is a regulatory term denoting reserves created against the possibility of credit losses identified in connection with specific credit assets and General provision is calculated on gross amount of loan. UAB is following CBM guidelines and providing adequate provision on loan and advances. As per latest issued regulation by CBM (instruction no.17/2017 dated 07-07-2017), specific provision and general provision requirement are as follow.

1. Watch Loan- Overdue 31 days to 60 days of default and specific Provision is 5% on security short fall amount.
2. Substandard loan- Overdue 61 days to 90 days of default and specific Provision is 25% on security short fall amount.
3. Doubtful loan- Overdue 91 days to 180 days of of default and specific Provision is 50% on security short fall amount.
4. Loss loan - Overdue more than 180 days of default and specific Provision is 100% on security short fall amount.
5. Banks are required to maintain general loan loss reserve by making general provisions up to 2 of total outstanding loans and advances.

In UAB, accounts are monitored closely, and delinquent accounts are reported to Management Credit Committee weekly basis for early remedial actions. According to the UAB's latest audited annual report, UAB is fully comply with CBM regulation of specific provision and general provision requirement. Monthly credit risk report and monthly approval list as per delegation of lending authority are submitted to Board Credit Committee and Management Credit Committee to control over the credit risks. Reports requested by CBM are submitted in timely manner. Hence, UAB credit risk controls is adequate as per Basel credit risk management principle topic no.4.

4.5 Non-Performing Loan (NPL) in UAB

Due to effective Credit Risk Management system in UAB, Concentration Risk Management by Exposure Ceilings, clear policies and procedure, total NPL account in UAB can controlled well. All the NPL accounts are fully secured by good collaterals and recovery proceedings are underway. UAB targeted NPL ratio is to be maintained less than 5% of total loan portfolio.

The status of non-performing loan to loans can be mentioned by calculating the ratio of NPL to total loan. The ratio can determine the extent of risk inherent in the loan portfolio. Regards to the formula for NPL to loans ratio is exactly as following;

NPL to Loans Ratio = (NPL / Total Loans) X 100

NPL ratio in UAB between 2016-2017 to 2018-2019 financial year is shown in table (4.6).

Table 4.6 NPL to Loan Ratio in UAB

	2016-2017	2017-2018	2018-2019
NPL Ratio (%)	2.07	4.83	4.65

Source: UAB annual report, 2019

According to Table 4.6, UAB NPL ratio is 2.07% in 2016-2017 and 4.83% and 4.65% in 2017-2018 and 2018-2019 respectively. Even though, NPL ratio is increased, it is still within bank’s targeted ratio of 5% of total loans.

CHAPTER 5
CONCLUSION

This chapter presents the summary and discussions on the findings of this study, suggestions, recommendation and need for further studies.

5.1 Findings and Discussion

The purpose of this study was to investigate credit risk management practices at UAB. The research was guide by the following objectives: To identify the credit risk management practices in UAB, To analyse the compliance status of Basel credit risk management principles in UAB. Primary data are collected from Face-to-Face interview with the respective officers and staffs, relevant file study provided by the officers concerned. Secondary data are collated from credit manuals issued by UAB Bank, UAB Bank Annual Report, relevant books, research papers, Internet website and various study selected reports

The first objective of the study was to identify the credit risk management practices in UAB. The finding established that UAB has in place sound credit risk management system. Procedures for credit process, from credit origination to recovery of the credit are defined clearly. The Board Credit committee and Management Credit Committee are regularly scheduled to discuss sizable credit applications and set their guidelines to mitigate potential risks. Internal controls are typically embedded in a bank's day to day business and designed to ensure, to the extent possible that bank's procedures are efficient and effective.

The second objective was to analyse the compliance status of Basel credit risk management principles in UAB. As per study, credit risk management in UAB is very effective and comply with Basle credit risk management principles. In UAB, roles of BOD and roles of Management are clearly defined. Policies are set by BOD in accordance with bank's risk appetite level and bank's expected profit level. Management implements the policies and develops the procedures for identifying, measuring, monitoring and controlling credit risk. Appropriate credit risk environment is established as per Basel credit risk management principle topic no.1.

Ceiling of loan segments are set and loans spread to different industries, different business segments and different geographical areas. Procedure for granting new loans and renew loans are in place and delegation of lending authority is given to different authority level. However, due to specific situation in Myanmar, such as business is concentrated in two major cities, lack of major industries/service sectors to finance, un-organized SME sector etc, concentration on Yangon geographical exposure, trading industry, corporate business segment and are high compare with bank targeted ceilings. Important regulation of Large exposure and liquidity management are complied.

Sound credit granting process is established as per Basel credit risk management principle topic no.2.

Credit recovery and follow up procedures are in place and NPL is well controlled. Even though NPL ratio is gradually increasing over years due to recession in real estate industry and other external factors influencing performance of trade and industrial sectors, UAB bank managed to control NPL ratio less than 5% and compared to market standard in Myanmar, it is a good position. Moreover, in UAB, credit rating system found very effective in controlling NPL. As per rating analysis, more than 95 of loan customers are rated UAB-1 to UAB-3. Rating system introduced in 2015 in UAB and it can choose the loan customers effectively and eligible loan amount also can decide easily. As a result, UAB can control NPL. It can see that the loan to NPL percentage of UAB is less than 5%. Provisions are fully provided for adequate coverage of loss. Credit risk is controls adequately. Internal audit and external audit are conducted periodically. Required reports are submitted to Management Credit Committee, Board Credit Committee and CBM in timely manner. Appropriate credit administration, measurement and monitoring process are maintained as per Basel credit risk management principle topic no.4.

5.2 Suggestion and Recommendations

The study established that UAB's credit risk management system is effective and mostly comply with Basel Credit Risk Management Principles which is evident from very low NPL ratio and good asset quality which is fully secured by collateral securities with good margin. Distribution of loans in to various sectors, managing concentration risk by distributing various loan sizes, and established process and procedures from top to bottom etc are established. CBM's Strict-lending norms regarding collaterals margins etc. are also contributing to the strength of UAB credit portfolio.

However, UAB still needs to upgrade their credit risk management as there are lots of changes in market, customers are more educated on banking than earlier and competition among banks are high. CBM also has released the instruction on relaxation of collateral. Hence, bank may not be in position to insist collateral for all case in the future. UAB has to analyses the creditworthiness of the customers and have to grant the credit based on repayment capacity of the borrowers. Hence more sound credit risk management is required to established. UAB needs to practice more international Credit risk assessment methods and move to latest Basle Guidelines on credit risk capital, provision requirements, insist for more documentary evidences on financial status of the borrowers to assess real financial strength of the borrower to reduce collateral requirements, introduce more loan products suitable for various industries, upgrade credit rating system, ensure proper usage of funds disbursed to borrowers and more stringent follow up methods etc.

5.3 Needs for Further Studies

The study only focused on the compliance status of Basel Credit Risk Management Principles in UAB Bank Limited. It is recommended that other studies should be done to determine how credit risk management affect profitability of the bank. And this study only focuses on Credit Risk Management of UAB Bank. It is suggested that such a study should be done in other banks also to know the over all credit risk management system of Myanmar Banking Industry.

Appendix

UAB Model Credit Rating Chart

	Risk Parameters	Risk Perception	Total Mark	Rating By		
				Branch	HO	CRMD
1	**RATING OF THE BORROWER**					
a)	**Length of Business started**	**5**				
	More than 5 Years	Low	5			
	1 to 5 Years	Moderate	3			
	Less than 1 Year/ New	High	2			
b)	**Promoters**	**8**				
	Well Known promoters with Market Reputation	Low	8			
	Locally known and Reasonably good market reputation	Moderate	6			
	Not known / New promoters	High	4			
	Known defaulter/ having adverse market reports	Very high	0			
c)	**Business Continuity**	**6**				
	Borrowers are below 60 and energetic to take on the business to higher level	Low	6			
	Customers are aged above 60 but there are, next generation business-persons to continue business	Moderate	5			
	Customers are aged above 60 and there are no legal heirs to continue business/ Borrower is single with no legal heirs	High	4			

d)	**Type of Business**	**5**				
	Ongoing continuous business activities - Full year	Low	**5**			
	Seasonal/ Depend on Government orders	Moderate	3			
	Occasional activities	High	2			
e)	**Business sector**	**6**				
	Trading activities – Local	Low	**5**			
	Imports – Trading	Low	**5**			
	Exports – Trading	Low	**6**			
	Imports & Exports / Local	Low	**6**			
	Trading – Gems/ Jades	Moderate	**4**			
	Trading – construction materials	High	**5**			
	Industrial units- Big	Low	**6**			
	Industrial Units – S & Medium	Moderate	**5**			
	Real Estate promoters	High	**3**			
	Service Industry	Moderate	**5**			
	Engaged in Government Projects	High	**4**			
	Agricultural/ Livestock	High	**4**			
	Other Business	High	**4**			
	No Business	Very high	**0**			
f)	**Management Quality**	**6**				
	Managed by Professionals/Experts in the business/ expatriates	Low	**6**			
	Managed by Locally experienced persons	Moderate	**4**			
	Other cases	High	**2**			
g)	**Previous Banking Experience**	**6**				
	Banking with UAB/any other banks and account copy provided shows good transactions (more than 30 of estimated turn over)	Low	**6**			

	Banking with UAB/ any other banks and account copy provided shows les transactions (10 to 30 of estimated turn over)	Moderate	**3**			
	Banking with any other banks and account copy provided shows NIL transaction (less than 10 of estimated turn over - Or NO bank accounts)	High	**0**			
h)	**Availability of Goods**	**5**				
	Goods/Products available in plenty	Low	**5**			
	Goods/Products generally available but with constraints	Moderate	**3**			
	Depending on restricted sources/ Other cases	High	**2**			
	Not Applicable	NA	**5**			
i)	**Business Performance**, (as per market reports/other documents provided/ account turn over)	**8**				
	Well performing business, financially disciplined	Low	**8**			
	Reasonable business achievements	Moderate	**5**			
	No details available/No records submitted to prove	High	**0**			
j)	**Profitability of Business** (as per market standards)	**6**				
	Business having potential to earn a profit margin of above 20 of Gross turn over	Low	**6**			

	Business having potential to earn a profit margin of above 10 to 20 of Gross turn over	Moderate	**5**			
	Business having potential to earn a profit margin of above 5 to 10 of Gross turn over	High	**4**			
	Business having potential to earn a profit margin of less than 5 of Gross turn over	Very high	**3**			
k)	**Purpose of Finance**	**8**				
	Purpose of finance is acceptable and clearly explained as per business details provided by the borrower	Low	**8**			
	Purpose of finance is acceptable, but requested facilities are high compared to actual requirement	Moderate	**4**			
	Purpose of finance is not clear, not explained well and required documents are not submitted	High	**0**			
l)	**Quality of information / transparency**	**8**				
	Whether customer has submitted all the required information by UAB	Low	**8**			
	Customer has submitted many information and copies of documents, but not full	Moderate	**6**			
	Customer is not ready to submit required information to UAB and not submitted majority of business information	High	**4**			

m)	**Diversification of Business**	**5**				
	Customer is engaged in more than 3 business activities and well diversified with good turn over in most of the business	Low	**5**			
	Customer is engaged in more than 1 business activities and reasonably diversified, with medium turn over from other business activities	Moderate	**4**			
	Customer is not diversified into other business activities	High	**3**			
n)	**Type of Major Facility**	6				
	LC/BG with minimum 20 Cash		**6**			
	STL for import/Export – Max 90 days		**5**			
	STL for Pledge/other self-liquidating		**5**			
	Term Loan with repayment M/Q		**5**			
	OD/TL with bullet payment		**3**			
o)	**Value to UAB – Expected**	**10**				
	Expected business from the customer/ Group is high-sure business to UAB	Low	**10**			
	There are potential for high other business from the customer/Group - But not sure that UAB can get it	Moderate	**5**			
	Less Potential for other business from customer/Group	High	**4**			
	No other business potential	Very high	**3**			
	Total marks to Customer rating					
	Rating of Borrower					

2)	**RATING OF SECURITY – LOAN RISK**					
a)	**Primary Security**	**10**				
	Hypothecation of stock/ Machinery/ receivables etc are available to UAB with good margin and are realisable easily	Low	**10**			
	Hypothecation of stock/ Machinery/ receivables etc are available to UAB with good margin but difficult to realise in reality	Moderate	**5**			
	No Primary security is available	Very High	**0**			
b)	**Collateral security**	**30**				
	Prime Residential properties/ commercial properties at YGN/ MDY/ NPT available with margin of more than 20 on FSV	Low	30			
	Prime Residential properties/ commercial properties at YGN/ MDY /NPT available with margin of less than 20 on FSV	Moderate	20			
	Prime Residential properties/ commercial properties at YGN/ MDY/ NPT available. Loan amount is more than 100 to less than 150 FSV	High	15			
	Industrial Lands / Other type of lands/ other area lands with sufficient margin (loan amount is less than 60 of FSV)	Low	25			
	Industrial Lands/ Other type of lands/ other area lands with sufficient margin	Moderate	20			

	(loan amount is 60 - 80 of FSV)					
	Industrial Lands/ Other type of lands / other area lands with sufficient margin (loan amount is more than 80- 100 of FSV)	High	15			
	Industrial Lands/ Other type of lands/ other area lands with sufficient margin (loan amount is more than 100 to 150 of FSV)	High	10			
	Loan value more than 150 of FSV or no collateral	Very high	0			
	Pledge of goods with loan amount less than 60 of value - Goods stored in Bank premises with full control of movement of stock	Low	25			
	Pledge of goods with loan amount less than 60 of value - Goods stored in customer premises with less control of movement of stock	High	15			
	Stand By LC, BG etc issued by other banks with rating BB- and above	Low	30			
	Stand By LC, BG etc issued by other banks without rating.	Moderate	20			
	BG issued by CBM/ Government of Myanmar etc	Low	30			
c)	**Guarantee**	**10**				
	Personal Guarantee of more than 2 persons available with sufficient net worth.	Low	**10**			
	Personal Guarantee of more than 2	Moderate	**6**			

	persons available, but no records to prove their net worth.					
	There are more than 2 borrowers, all with sufficient net worth	Low	**1 0**			
	There are more than 2 borrowers, but net worth of borrowers, are not known	Moderate	**6**			

UAB Rating Chart

No.	Percentage obtained	Rating
1	≥ 80	UAB-1
2	≥ 70	UAB-2
3	≥ 60	UAB-3
4	≥ 50	UAB-4
5	≥ 40	UAB-5

(Source: UAB Bank 2019)

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