



Bank of India

Credit Officers

Volume - 1

Credit Management & Recovery Management and Risk Management



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CHAPTER

Credit Management

Credit Management

- Credit management is the process of deciding which customers to extend credit to and evaluating those customers' creditworthiness over time. It involves setting credit limits for customers, monitoring customer payments and collections, and assessing the risks associated with extending credit to customers.
- The risk of customers defaulting on payment is a high concern in B2B, with nearly half of all B2B invoices in the US getting paid late according to a 2022 Atradius Survey. Effective credit management processes help businesses mitigate this early on.

Process of credit management

1. Loan Application

- ✓ The customer submits a loan or credit facility application.
- ✓ Required documents are collected, such as identity proof, income proof, bank statements, financial statements (for businesses), and collateral details.

2. Credit Assessment

- ✓ The bank evaluates the applicant's creditworthiness by analyzing:
 - Credit history and credit score
 - Income and repayment capacity
 - Existing debt obligations
 - Financial statements (for businesses)
 - Industry and market conditions
 - Collateral offered

3. Risk Analysis

- ✓ The bank assesses the level of credit risk by considering:
 - Probability of default
 - Loss given default
 - Regulatory and compliance requirements
 - Exposure at default
 - Internal credit rating

4. Credit Approval

- ✓ The proposal is reviewed by the appropriate credit authority or credit committee.
- ✓ The loan may be approved, modified, or rejected.
- ✓ Credit limits, interest rates, tenure, repayment schedule, and covenants are finalized.

5. Documentation and Disbursement

- ✓ Legal agreements and loan documents are executed.
- ✓ Security interests are created and collateral is verified.
- ✓ The loan amount is disbursed according to the agreed terms.

6. Credit Monitoring

- ✓ After disbursement, the bank continuously monitors:
 - Timely repayment of installments
 - Customer's financial performance
 - Overall credit exposure
 - Compliance with loan covenants
 - Changes in collateral value

7. Collection and Recovery

- ✓ If repayments are delayed:
 - Payment reminders and follow-ups are initiated.
 - Loan restructuring or rescheduling may be considered, where appropriate.
 - Recovery actions are taken according to the bank's policies and applicable regulations.

8. Non-Performing Asset (NPA) Management

- ✓ If the borrower fails to repay within the regulatory timeline:
 - The account is classified according to applicable asset classification norms.
 - Provisions are made as required.
 - Recovery measures, including legal proceedings or enforcement of collateral, may be initiated.

9. Credit Review and Renewal

- ✓ For revolving credit facilities or periodic reviews:
 - The bank reassesses the borrower's financial position.
 - Credit limits and terms may be renewed, increased, reduced, or withdrawn based on the review.

Objectives of Credit Management in Banking

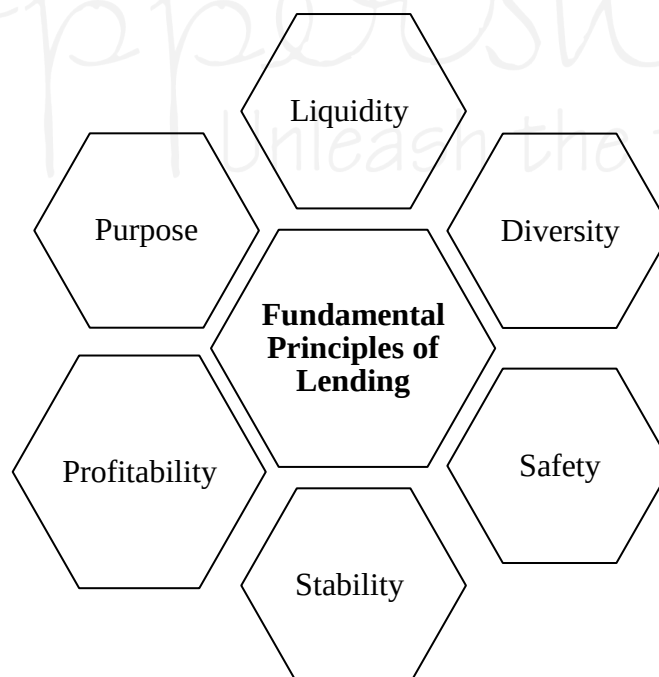
- Minimize credit losses and defaults.
- Maintain a high-quality loan portfolio.
- Ensure compliance with regulatory requirements.
- Improve profitability through effective lending.
- Support customers with responsible access to credit.
- Maintain adequate capital and manage overall credit risk.

Fundamentals of Credit

- **The 5 Cs of Credit**
- Banks commonly evaluate borrowers using the **5 Cs of Credit**:
 1. **Character**: The borrower's reputation and willingness to repay.
 2. **Capacity**: The ability to generate sufficient income to repay the loan.
 3. **Capital**: The borrower's financial strength and net worth.
 4. **Collateral**: Assets pledged to secure the loan.
 5. **Conditions**: Economic, industry, and loan-specific factors that could affect repayment.

Principles of Lending

- Lending is not without its risks, especially when lending banks rely heavily on borrowed capital.



1. **Liquidity**: Bank lending is based on the idea of liquidity. Banks only lend for short durations because they are lending public money that depositors can withdraw at any time. As a result, they make loans secured by easily marketable assets that they can convert into cash at a moment's notice. It is one of the foremost Principle of Lending.

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2. **Diversity:** A commercial bank should use the principle of diversification when deciding on its investment portfolio. It should invest its surplus cash in various assets rather than a single type of investment. It should select shares and debentures from various industries located in various parts of the country. Diversification tries to reduce the risk in a bank's investment portfolio.
 3. **Safety:** Safety means that the borrower should be able to repay the loan and interest in time at regular intervals without default. The repayment of the loan depends upon the nature of security, the character of the borrower, his capacity to repay, and his financial standing.
 4. **Stability:** Another essential component of a bank's investment strategy should be to invest in stocks and assets with a high degree of price stability. The bank cannot afford to lose any of its securities' value, and as a result, it should place its money into shares of well-known companies with a low likelihood of price declines.
 5. **Profitability:** This is the foundational principle behind a bank's investment decisions. It must be profitable enough, and as a result, it should invest in securities that guarantee a fair and consistent return on investment. The ability of stocks and shares to earn money is determined by the interest rate, dividend rate, and tax benefits they provide.
 6. **Purpose:** Loans for unfavorable or speculative purposes are not available. Even though the profits from such economic activities are higher, a bank cannot use these loans at that time.

Credit Policy

- Credit administration is an important division in any lending organization. They are responsible for overseeing the entire credit procedure and ensuring that loans are provided only to low-risk customers. It also helps the banks take necessary measures to retrieve the loan if it is overdue.
- The credit policy is a document that determines all the guidelines that allow lending companies to make these critical lending decisions. These guidelines are important for risk management and provide necessary guidelines to the staff to effectively manage clients' portfolios.

RBI Credit Policy

- The RBI credit policy, also known as the monetary policy, is instrumental in determining the money supply, the economy's credit cost, and other national monetary matters. This credit policy is also important for distributing any credit among borrowers, lending rates, and other key indicators.
- **The primary indicators of the RBI credit control policy are:**
 - ✓ **Cash Reserve Ratio:** This is a fixed amount of cash that the banks must set aside for the RBI. This amount cannot be used for lending or obtaining any interest.
 - ✓ **Statutory Liquidity Ratio:** These are liquid assets like RBI-approved securities or gold that the bank must set aside.
 - ✓ **Bank Rate:** The rate at which funds are lent to banks by the RBI.
 - ✓ **Repo Rate:** The interest rate paid by the RBI to the banks upon any additional deposits.
 - ✓ **Marginal Standing Facility Rate:** This is the rate at which banks can borrow money from the Central Bank.
- The monetary policy of the RBI is responsible for improving the transmission of loans, providing aid to banks during a financial deficit, creating the standards for lending and borrowing and improving financial inclusion by creating policies that eliminate any individual lenders.

Importance of Credit Policy

- Banks use different types of credit policies when providing a loan or a credit card. The credit policy is an agreement between the bank and the customer.
- **It communicates the following to the customer with complete clarity:**
 - ✓ The eligibility criteria for the individual to avail themselves of the loan.
 - ✓ The margin and security required to avail a loan.
 - ✓ The repayment terms for the loan or credit card.
 - ✓ The penalties that the customer is liable to pay for delayed payments, prepayment, foreclosure etc.

- ✓ The process of collection in case of any default.
- ✓ Legal action may be taken if the loan is overdue beyond the given time.
- For customers, this document helps ensure that the payments are made on time towards any credit availed. It also helps you understand if your application will be accepted when you submit it to a lender. These factors are necessary for your **credit monitoring** and monitoring your CIBIL score.

Types of Credit Policy

- There are various **types of credit policy** lending institutions used based on the product being extended to the customer.
- **This includes:**
 1. **Automotive credit policies:** This includes any vehicle loans availed by the customer.
 2. **Personal credit policies:** This credit policy determines the minimum credit score for a personal loan, the quantum of finance, interest rate etc.
 3. **Business/ wholesale credit policy:** This credit policy includes all products for business operations credit and capital loans for various industries. These policies depend upon the nature of the business and the scale of the business primarily.
 4. **Home loan credit policy:** It includes the security terms, the margin to be paid, the minimum credit score for a home loan and other primary factors.
 5. **Academic credit policy:** This refers to education loans provided for higher studies, including the holiday period for the loans, along with other factors.
 6. **Credit card policy:** This credit policy is listed by institutions that offer credit cards to customers.

Credit Control Policy

- The credit-control policy is one of the most important tools used by the RBI to enforce its monetary policy.
- The objective of the credit-control policy is to meet the credit flow requirements in the economy.
- In order to control any **credit policy of banks** that offer commercial loans, the credit-control policy uses the following tools:
 1. **Quantitative Measure of Credit Control:** This includes the cash reserve ratio and the statutory liquid ratio. These parameters determine the volume of credit available in the economy. It also affects the cost of credit depending upon the assets of commercial banks that are available to the RBI.
 2. **Open market operations:** Any transactions made towards government securities by the Reserve Bank of India in the open market is determined by this tool. The credit volume increases when RBI invests in these securities and decreases when it sells the securities.
 3. **Policy Rates:** This includes RBI rates of interest like the Bank Rate Policy, The Repo Rate and Marginal Standing Facility. The objective is to provide standards to the banks based on which they can create internal interest rate policies based on the CIBIL score range, lender profile and other factors.
 4. **Qualitative Measures of Credit Control:** These tools determine how the credit is used and the direction of the credit flow. It includes credit rationing, which controls the credit available for various industrial sectors. It also includes moral suasion, which persuades commercial banks to create a credit policy that can improve the economy and boost the interest of the country's economy. Lastly, it lists changing margin requirements that determine the securities that should be provided against any loan extended by a commercial bank.

Credit Process

Flow of the Credit Process

Credit Application → Credit Investigation → Credit Appraisal → Credit Approval → Documentation
→ Loan Disbursement → Credit Monitoring → Collection & Recovery → Loan Closure

1. Credit Request

- ✓ The customer applies for a loan or credit facility.
- ✓ Required documents, such as identity proof, income proof, financial statements, and collateral details, are collected.

2. Credit Investigation and Analysis

- ✓ Verify the customer's identity and documentation.
- ✓ Analyze financial statements, income, cash flows, and existing liabilities.
- ✓ Review the customer's credit history and repayment behavior.
- ✓ Assess the borrower's repayment capacity and risk profile.

3. Credit Appraisal

- ✓ Evaluate the feasibility of the loan.
- ✓ Assess the purpose of the loan, collateral, and associated risks.
- ✓ Assign an internal credit rating or risk grade.

4. Credit Decision and Approval

- ✓ The credit proposal is reviewed by the appropriate credit authority or credit committee.
- ✓ The loan is approved, modified, or declined based on the bank's credit policy.
- ✓ Credit limits, interest rates, repayment terms, and conditions are finalized.

5. Documentation

- ✓ Execute the loan agreement and other legal documents.
- ✓ Verify and register collateral or security, where applicable.
- ✓ Ensure all regulatory and compliance requirements are met.

6. Loan Disbursement

- ✓ Disburse the approved loan amount according to the agreed terms and conditions.
- ✓ Record the transaction in the bank's systems.

7. Credit Administration and Monitoring

- ✓ Monitor repayment performance and account activity.
- ✓ Ensure compliance with loan covenants and conditions.
- ✓ Periodically review the borrower's financial position and collateral value.

8. Collection and Recovery

- ✓ Send payment reminders before and after due dates.
- ✓ Follow up on overdue accounts.
- ✓ Consider restructuring or rescheduling where appropriate.
- ✓ Initiate recovery or legal action if the borrower defaults.

9. Credit Review and Closure

- ✓ Conduct periodic reviews of the loan and the borrower's creditworthiness.
- ✓ Close the loan account once the principal, interest, and all charges have been fully repaid.
- ✓ Release any collateral after all obligations have been satisfied.

Credit Delivery

- Credit Delivery is the process through which a bank provides approved credit facilities to customers efficiently, securely, and in compliance with its policies and regulatory requirements. It begins after the loan has been approved and continues until the funds are disbursed and made available to the borrower.

Stages of Credit Delivery

1. Loan Sanction

- ✓ The bank approves the loan based on credit appraisal.
- ✓ A sanction letter is issued specifying:
 - Loan amount
 - Interest rate
 - Repayment schedule
 - Security/collateral
 - Terms and conditions

2. Documentation

- ✓ The borrower signs the loan agreement and other legal documents.
- ✓ The bank verifies all required documents.
- ✓ Security documents and guarantees are executed.

3. Creation of Security

- ✓ Collateral is legally charged or pledged to the bank.
- ✓ Insurance and valuation requirements are completed where applicable.

4. Pre-Disbursement Compliance

- ✓ The bank ensures that all sanction conditions have been fulfilled.
- ✓ Regulatory, legal, and internal policy requirements are verified.

5. Loan Disbursement

- ✓ Funds are released to the borrower or directly to the supplier/vendor, depending on the purpose of the loan.
- ✓ **The disbursement may be:**
 - **Full disbursement** - Entire loan amount is released at once.
 - **Partial or phased disbursement** - Funds are released in stages based on project progress or milestones.

6. Post-Disbursement Monitoring

- ✓ The bank monitors the utilization of funds.
- ✓ It ensures repayments are made according to the agreed schedule.
- ✓ The bank periodically reviews the borrower's financial condition and the value of any collateral.

Types of Borrowers

➤ Banks analyze and process these borrowers through distinct legal and operational frameworks:

1. Individual Borrowers

- ✓ Ordinary people who secure financing for personal needs, such as home mortgages, auto loans, or educational funding
- ✓ **Legal Requirements:** Must be legally competent to contract (minimum 18 years of age and of sound mind)

2. Business Borrowers: Entities that borrow capital to start, operate, or expand an enterprise

- ✓ **Sole Proprietorships:** Owned by a single person. While the business isn't a separate legal entity from the owner, banks extend credit based on the owner's personal creditworthiness.
- ✓ **Partnership Firms:** Governed by the Indian Partnership Act 1932. Partners have joint and unlimited liability. Banks must verify the authority of active partners to borrow and manage the firm's accounts.
- ✓ **Hindu Undivided Families (HUF):** A unique Indian business entity where the senior-most member (the *Karta*) manages the accounts and acts as the authorized borrower on behalf of the family.
- ✓ **Corporate Borrowers (LLPs, Private/Public Ltd):** Legal entities governed by the Companies Act. Borrowing capacity is heavily regulated by the firm's Memorandum of Association and shareholder resolutions.

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3. **Institutional Borrowers:** Organizations formed for community, religious, or operational benefits.
 - ✓ **Trusts and Co-operative Societies:** Governed by respective trust deeds or cooperative acts
 4. **Government Borrowers:** The central or state governments acting as borrowers.
 - ✓ **Mechanism:** Governments borrow through financial instruments like sovereign bonds and treasury bills to fund public infrastructure and fiscal deficits

Characteristics of Loans

1. Principal Amount

- ✓ The original amount of money borrowed from the bank.
- ✓ The borrower is obligated to repay the principal according to the agreed terms.

2. Interest

- ✓ The cost of borrowing money, charged by the lender.
- ✓ Interest may be **fixed** or **floating (variable)**.

3. Repayment Period (Tenure)

- ✓ The duration within which the loan must be repaid.
- ✓ It may range from a few months to several years, depending on the type of loan.

4. Repayment Schedule

- ✓ Specifies how the loan will be repaid.
- ✓ **Repayment may be through:**
 - Monthly installments (EMIs)
 - Quarterly or annual payments
 - Bullet repayment at maturity

5. Purpose

- ✓ Every loan is granted for a specific purpose, such as:
 - Personal needs
 - Home purchase
 - Education
 - Business expansion
 - Vehicle purchase

6. Security (Collateral)

- ✓ **Loans may be:**
 - **Secured Loans:** Backed by collateral such as property, vehicles, or fixed deposits.
 - **Unsecured Loans:** Granted without collateral based on the borrower's creditworthiness.

7. Creditworthiness

- ✓ Loan approval depends on the borrower's ability and willingness to repay.
- ✓ Banks assess income, credit history, financial stability, and repayment capacity.

8. Risk

- ✓ Every loan carries a risk of default.
- ✓ Banks manage this risk through credit appraisal, collateral, guarantees, and continuous monitoring.

9. Documentation

- ✓ Loans require legal documentation, including:
 - Loan agreement
 - Identity and income proofs
 - Security documents
 - Other regulatory documents

10. Legal Obligation

- ✓ A loan is a legally binding contract.
- ✓ The borrower must comply with the agreed terms and conditions.
- ✓ Failure to repay may result in penalties, legal action, or recovery of collateral.

Types of Loans

Based on the Security Provided

1. **Secured Loans:** These loans require the borrower to provide collateral for the money being borrowed. If the borrower cannot repay the loan, the bank can utilize the given collateral to recover the pending payment. The interest rate for such loans is much lower than that of unsecured loans.
2. **Unsecured Loans:** Unsecured loans do not require collateral for loan disbursement. The bank analyses the borrower's past relationship with the bank, the credit score, and other factors to determine whether the loan should be given. The interest rate for such loans can be higher, as there is no way to recover the loan amount if the borrower fails to pay off the loan.

Based on the Purpose

1. **Education Loan:** They are financial aid that borrowers can use to pursue education. The loan is only valid when the course is an undergraduate degree, a postgraduate degree, or any other diploma/certification course from a reputed institution/university. You must have the admission pass provided by the institution to get the financing. The financing is available for both domestic and international courses.
2. **Personal Loan:** You can go for a personal loan whenever there is a liquidity issue. A personal loan can range from repaying an old debt, going on vacation, funding for the downpayment of a house/car, and medical emergency to purchasing big-ticket furniture or gadgets. These loans are offered based on the applicant's past relationship with the lender and credit score.
3. **Vehicle Loan:** Vehicle loans finance the purchase of two-wheeler and four-wheeler vehicle. They can be used to purchase both new and second-hand four-wheelers. The lender determines the loan amount based on the vehicle's on-road price. You may need to make a down payment, as these loans rarely offer 100% financing. The lender retains ownership of the vehicle until the loan is fully repaid.
4. **Home Loan:** They provide funds to purchase a house or flat, construct a house, renovate/repair an existing house, or purchase a plot for the construction of a house or flat. The lender will hold the property until the rightful owner has completed their repayments.
5. **Business Loan:** Business loans are made to fund business-related needs, such as working capital, expansion, equipment purchases, or operational costs. The amount sanctioned depends on the business's financials and the applicant's credit profile. Both secured and unsecured variants are available.
6. **Top-up Loan:** Top-up loans are offered in addition to an existing home or personal loan. These loans do not require additional documentation and are processed faster than fresh loans. The top-up amount can be used for any personal or professional purpose.

Based on the Pledged Assets

1. **Gold Loan**

- ✓ Many financiers and lenders offer cash when the borrower pledges physical gold, such as jewelry or gold bars/coins. The lender weighs the gold and calculates the amount offered based on several checks of purity and other factors. The money can be used for any purpose.
- ✓ The loan must be repaid in monthly instalments so that it can be cleared by the end of the tenure and the gold can be taken back to the borrower's custody. If the borrower fails to repay on time, the lender reserves the right to take over the gold to recover the losses.

2. **Loan Against Assets**

- ✓ Like pledging gold, individuals and businesses pledge property, insurance policies, FD certificates, mutual funds, shares, bonds, and other assets to borrow money. Based on the value of the pledged assets, the lender will offer a loan with some margin.
- ✓ The borrower needs to make repayments on time so that they can get custody of the pledged assets at the end of the tenure. Failing to do so, the lender can sell the assets to recover the defaulted money.

3. Loan Against Property

- ✓ This type of loan is taken by pledging residential or commercial property. The loan amount sanctioned is usually a percentage of the property's market value. These loans are ideal for long-term needs such as higher education, business expansion or significant medical expenses.

Government Policies & Regulations on Credit

- Government policies and regulations on credit are the rules and measures used by governments and financial regulators to ensure that lending is fair, stable, and supports economic growth. Key policies include:

1. Monetary Policy

- ✓ Usually managed by a country's central bank, monetary policy influences the availability and cost of credit.
- ✓ Lower interest rates encourage borrowing and investment.
- ✓ Higher interest rates discourage borrowing and help control inflation.

2. Banking Regulations

- ✓ Governments require banks to follow rules that promote financial stability, such as:
 - Maintaining minimum capital reserves.
 - Keeping enough liquid assets.
 - Following responsible lending practices.

3. Consumer Protection Laws

- ✓ These regulations protect borrowers by requiring lenders to:
 - Clearly disclose interest rates, fees, and loan terms.
 - Avoid unfair or deceptive lending practices.
 - Provide mechanisms for resolving customer complaints.

4. Credit Reporting Regulations

- ✓ Governments regulate credit bureaus to ensure:
 - Accurate credit information.
 - Consumer access to their credit reports.
 - Procedures for correcting errors in credit records.

5. Priority Sector Lending (in some countries)

- ✓ Banks may be required to provide loans to sectors that are important for economic development, such as:
 - Agriculture
 - Small businesses
 - Education
 - Affordable housing

6. Interest Rate Regulations

- ✓ In some cases, governments set limits on interest rates or regulate lending rates to protect borrowers from excessive charges.

7. Financial Inclusion Policies

- ✓ Governments encourage access to credit for underserved populations through:
 - Low-interest loan schemes.
 - Microfinance programs.
 - Digital banking initiatives.
 - Credit guarantee schemes for small businesses.

8. Anti-Money Laundering (AML) and Know Your Customer (KYC) Rules

- ✓ Financial institutions must:
 - Verify customer identities.
 - Monitor suspicious transactions.
 - Report illegal financial activities to authorities.

Objectives of Credit Regulations

- Promote economic growth.
- Maintain financial stability.
- Protect consumers.
- Prevent financial fraud and money laundering.
- Ensure fair access to credit.
- Reduce the risk of banking crises.



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CHAPTER

Credit Appraisal

Credit Appraisal

- Credit appraisal is the process through which a lender evaluates the creditworthiness of a borrower before granting a loan. It involves assessment of the borrower's financial health, including their income, credit history, debt repayment track record, and overall financial stability. Lenders typically examine the borrower's credit score, income documents, employment stability, and any outstanding loans to determine the risk involved in lending money.

Appraisal Process: 8 Steps of Credit Appraisal

- Credit appraisal is the process through which lenders evaluate a borrower's financial health and ability to repay a loan before approval.
- **Here's the step-by-step appraisal process:**
 1. **Application Review:** The borrower submits a loan application, providing necessary financial details.
 2. **Document Verification:** Verification of documents like income proof, bank statements, and employment details.
 3. **Credit Score Check:** The lender reviews the borrower's credit score to assess past repayment behavior.
 4. **Income Assessment:** The borrower's income is analyzed to ensure they can meet repayment obligations.
 5. **Debt Analysis:** Existing debts are evaluated to determine the borrower's debt-to-income ratio.
 6. **Risk Evaluation:** The lender assesses overall financial risk, considering external factors.
 7. **Decision Making:** The loan approval or rejection is determined based on the assessment.
 8. **Loan Agreement:** If approved, the terms and conditions of the loan are finalized and signed.

Importance of Credit Appraisal in Loan Approval

- Credit appraisal not only protects lenders but also helps borrowers to access loan that aligns with their financial capabilities.
 - ✓ **Minimizes risk:** Credit appraisal helps lenders assess the risk associated with lending money, ensuring they avoid high-risk borrowers.
 - ✓ **Helps in Right Decision-Making:** By evaluating the eligibility and financial capability of applicants, credit appraisal ensures loans are granted to suitable individuals.
 - ✓ **Reduces Default Risk:** It screens out high-risk applicants, thereby minimizing the likelihood of defaults and ensuring loans are given to financially stable candidates.
 - ✓ **Ensures Compliance with Regulations:** The process adheres to guidelines set by regulatory authorities to maintain proper lending practices.

Eligibility Criteria for Credit Appraisal

- The requirements for eligibility differ according to the lender. The following are some typical qualifying requirements that lenders request:
 - ✓ **Income:** In order to determine if a borrower can make timely loan repayments, lenders look into the borrower's financial situation. Therefore, one of the key components of the eligibility requirements is income.
 - ✓ **Credit History:** An important factor in evaluating your loan application is your . Lenders can more easily determine that a borrower can manage their financial responsibilities responsibly and has a strong payment history if they have a clean credit history.

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- ✓ **Collateral:** As part of the credit appraisal process, lenders assess the collateral offered when providing a secured loan. This collateral serves as a safeguard, allowing lenders to recover their funds in case the borrower defaults on the loan.
 - ✓ **Loan to Cost Ratio:** This ratio is calculated based on how much borrowers can pay based on the total amount they requested. This ratio helps to calculate how much can be lent to the customer.
 - ✓ **Debt-to-Income Ratio:** The ratio helps assess the borrower's financial position in relation to their current income. A lower ratio indicates fewer existing debts, making the borrower more capable of repaying the loan without a high risk of default.

Factors to Considered During Credit Appraisal

- **Credit History:** The lenders assess the past loan repayment records and credit behavior.
- **Income Stability:** The borrower's income stability is important and sufficient income flow for timely repayments is essential.
- **Debt-to-Income Ratio:** This ratio helps to measure the borrower's capacity to manage monthly loan payments.
- **Collateral:** For secured loans, the value and quality of the collateral offered.
- **Business Viability:** Borrowers must submit their whole starting plan, including their financial predictions and payback schedules, in order to be eligible for business loans.

Benefits of Credit Appraisal

- Below are the benefits of credit appraisal:
 - ✓ **Reduces Default Risks:** By rejecting loan applications that don't match the loan eligibility criteria, credit appraisal process enables lenders to offer loans to borrowers without fear of losing funds.
 - ✓ **Financial Transparency:** This provides a clear picture of the borrower's financial condition.
 - ✓ **Determine loan amount:** Lenders use credit appraisal to determine how much they may lend to a borrower.

Common Challenges in Credit Appraisal

- **Low Credit Score:** A poor credit score can impact the loan approval.
- **Incomplete Documentation:** Missing financial records can cause delays in the loan application procedure overall.
- **Unstable Income:** It could be difficult for applicants with unstable income to pass credit checks.
- **High Debt-to-Income Ratio:** An excessively high ratio suggests a high debt-to-income ratio, which may reduce the likelihood of approval.
- **Overvalued Collateral:** Delays or rejections may result from incorrect collateral value.

Steps Involved in the Credit Appraisal

- **The credit appraisal process has several steps to evaluate the loan application:**
 - ✓ **Step 1:** Start by ensuring you meet the basic eligibility criteria, such as income, age, and other requirements set by the lender.
 - ✓ **Step 2:** Gather all necessary documents, including income proof, identity proof, and bank statements, to support your loan application.
 - ✓ **Step 3:** Lenders will then conduct a CIBIL check online to review your credit score and determine if it meets the minimum threshold for loan eligibility.
 - ✓ **Step 4:** To gain deeper insights into your financial situation, banks and NBFCs may conduct a personal discussion with you.
 - ✓ **Step 5:** For larger loans, some lenders may visit your home or business premises to verify the information provided.
 - ✓ **Step 6:** The next step involves a comprehensive evaluation of your finances, including income and existing debts, to assess your repayment capacity.

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- ✓ **Step 7:** A detailed report is prepared, compiling all the information gathered throughout the process.
 - ✓ **Step 8:** Based on this report, the lender will make a decision to either approve or reject the loan application.

Credit Screening

- **Credit Screening** is the process used by lenders to evaluate whether a borrower is eligible for a loan or credit and to assess the likelihood that the borrower will repay the debt on time.

Objectives of Credit Screening

- Assess the borrower's creditworthiness.
- Minimize the risk of loan defaults.
- Ensure responsible lending.
- Determine suitable loan terms and interest rates.

Factors Considered in Credit Screening

1. **Credit History:** Past record of borrowing and repayment.
2. **Credit Score:** A numerical score indicating the borrower's creditworthiness.
3. **Income:** Regular income to ensure capacity repayment.
4. **Employment Status:** Job stability and employment history.
5. **Existing Debts:** Current loans and financial obligations.
6. **Collateral:** Assets pledged as security for secured loans.
7. **Debt-to-Income Ratio (DTI):** Comparison of monthly debt payments to monthly income.

Credit Screening Process

1. Receive the loan application.
2. Verify the applicant's identity and documents.
3. Review the applicant's credit report and credit score.
4. Assess income, expenses, and repayment capacity.
5. Evaluate collateral (if applicable).
6. Approve, reject, or request additional information.

Credit Investigation

- **Credit Investigation** is the process of collecting and verifying detailed information about a loan applicant to determine their **creditworthiness**, repayment capacity, and financial reliability before granting credit.

Objectives of Credit Investigation

- Assess the applicant's ability to repay the loan.
- Verify the accuracy of the information provided.
- Minimize the risk of loan defaults.
- Make informed lending decisions.

Sources of Information

- Loan application form.
- Credit reports from credit bureaus.
- Bank statements.
- Income and salary records.
- Employer verification.
- Trade or business references.
- Financial statements (for businesses).

Steps in Credit Investigation

1. Receive and review the loan application.
2. Verify the applicant's identity and documents.
3. Check credit history and credit score.
4. Verify employment, income, and financial stability.
5. Evaluate existing debts and repayment capacity.
6. Inspect collateral, if required.
7. Prepare a credit investigation report.
8. Approve or reject the loan based on the findings.

Feasibility Study

A **feasibility study** is a systematic analysis conducted to determine whether a proposed project, business, or investment is practical, achievable, and financially worthwhile before it is undertaken.

Objectives of a Feasibility Study

- Determine whether a project is possible and sustainable.
- Identify potential risks and challenges.
- Estimate costs, benefits, and expected returns.
- Support decision-making by investors, lenders, and managers.

Types of Feasibility Analysis

1. **Technical Feasibility**
 - ✓ Examines whether the required technology, equipment, skills, and resources are available.
2. **Financial Feasibility**
 - ✓ Evaluates project costs, funding requirements, expected revenue, profitability, and cash flow.
3. **Market Feasibility**
 - ✓ Studies customer demand, competition, market size, and growth opportunities.
4. **Operational Feasibility**
 - ✓ Determines whether the organization has the capability to operate and manage the project effectively.
5. **Legal Feasibility**
 - ✓ Reviews laws, regulations, licenses, and compliance requirements.
6. **Time Feasibility**
 - ✓ Assesses whether the project can be completed within the required timeframe.

Steps in Conducting a Feasibility Study

1. Define the project objectives and scope.
2. Collect relevant data and information.
3. Analyze technical, financial, market, and operational factors.
4. Identify risks and possible solutions.
5. Compare expected costs and benefits.
6. Prepare a feasibility report with recommendations.

Fundamental credit issues

Fundamental credit issues are the basic factors and challenges that affect the granting, management, and repayment of credit. These issues help lenders evaluate the risks involved in providing loans or other forms of credit.

1. Creditworthiness of Borrowers

- ✓ Determining whether a borrower has the ability and willingness to repay the loan.
- ✓ Based on factors such as income, credit history, financial stability, and past repayment behavior.

2. Credit Risk

- ✓ The possibility that a borrower may fail to repay the principal or interest on time.
- ✓ Lenders assess risk before approving credit to reduce potential losses.

3. Repayment Capacity

- ✓ Evaluating whether the borrower's income or cash flow is sufficient to meet loan obligations.
- ✓ Includes analysis of debt levels, expenses, and future earning potential.

4. Credit Information Accuracy

- ✓ Reliable information about borrowers is essential for proper lending decisions.
- ✓ Incorrect or incomplete credit records can lead to poor lending decisions.

5. Collateral and Security

- ✓ Assessing whether assets offered as security are sufficient and legally acceptable.
- ✓ Collateral helps reduce lender losses if the borrower defaults.

6. Interest Rate and Credit Terms

- ✓ Setting appropriate interest rates, repayment periods, and loan conditions.
- ✓ Terms must balance lender risk with borrower affordability.

7. Default and Non-Performing Loans

- ✓ Loans that are not repaid according to agreed terms create financial problems for lenders.
- ✓ Effective credit monitoring helps identify and manage problem loans.

8. Credit Policy and Regulation

- ✓ Lending decisions must follow internal credit policies and government regulations.
- ✓ Regulations promote responsible lending and protect borrowers.

9. Moral Hazard and Adverse Selection

- ✓ **Adverse selection:** Risk of lending to borrowers who are more likely to default.
- ✓ **Moral hazard:** Borrowers may take excessive risks after receiving credit.

10. Credit Monitoring and Recovery

- ✓ Continuous monitoring ensures borrowers remain capable of repayment.
- ✓ Recovery procedures help lenders manage overdue or defaulted loans.

Evaluating Commercial Loan Requests

Evaluating commercial loan requests is the process used by banks and financial institutions to assess whether a business is capable of repaying a loan and whether the loan purpose presents an acceptable level of risk.

Objectives of Commercial Loan Evaluation

- Determine the creditworthiness of the business.
- Assess the ability to repay the loan.
- Measure the risks associated with lending.
- Decide appropriate loan terms and conditions.

Key Factors Considered in Commercial Loan Evaluation

1. Character of the Borrower

- ✓ Examines the reputation, integrity, and reliability of the business owners and management.
- ✓ Includes reviewing credit history, experience, and past repayment behavior.

2. Capacity to Repay

- ✓ Evaluates whether the business generates enough cash flow to repay the loan.
- ✓ Analyzes sales, profits, operating expenses, and debt obligations.

3. Capital Strength

- ✓ Reviews the amount of the owner's investment in the business.
- ✓ A stronger capital position indicates greater financial stability.

4. Collateral

- ✓ Assesses assets offered as security for the loan.
- ✓ May include property, equipment, inventory, or receivables.

5. Conditions of the Loan and Business Environment

- ✓ Considers the purpose of the loan, economic conditions, industry trends, and market competition.
- ✓ Determines whether external factors may affect repayment.

6. Financial Statement Analysis

Lenders review:

- ✓ Balance sheets.
- ✓ Income statements.
- ✓ Cash flow statements.
- ✓ Profitability and liquidity ratios.
- ✓ Debt levels.

7. Business Plan and Loan Purpose

- ✓ Evaluates whether the loan purpose is reasonable and supports business growth.
- ✓ Reviews projected income, expenses, and future plans.

8. Management Quality

- ✓ Examines the skills, experience, and decision-making ability of business managers.
- ✓ Strong management improves the likelihood of successful loan repayment.

9. Credit History and Existing Obligations

- ✓ Reviews previous borrowing records and current debts.
- ✓ Helps identify repayment patterns and financial risks.

Borrowers Study

A **borrower study** is a detailed examination of a borrower's financial condition, business operations, credit history, and repayment ability conducted by a lender before approving a loan.

Objectives of Borrower Study

- Assess the borrower's creditworthiness.
- Determine the ability to repay the loan.
- Identify potential risks associated with lending.
- Support sound lending decisions.

Areas Covered in a Borrower Study

1. Personal Background

- ✓ Identity, experience, reputation, and financial responsibility of the borrower.
- ✓ For businesses, includes the background of owners and management.

2. Credit History

- ✓ Previous borrowing records.
- ✓ Repayment patterns and outstanding obligations.

3. Financial Position

- ✓ Income, assets, liabilities, and overall financial strength.
- ✓ Analysis of financial statements for businesses.

4. Repayment Capacity

- ✓ Ability to generate sufficient income or cash flow to repay the loan.
- ✓ Evaluation of debt obligations and future earnings.

5. Business Operations

- ✓ Nature of business, industry position, customers, suppliers, and competition.

6. Collateral and Security

- ✓ Value and legal status of assets offered as loan security.

7. Purpose of Loan

- ✓ Whether the loan purpose is reasonable, productive, and financially justified.

Banker's Opinion

A **banker's opinion** is the professional judgment of a banker regarding the creditworthiness, reliability, and repayment ability of a borrower based on the information gathered during the credit evaluation process.

Factors Influencing a Banker's Opinion

- Borrower's character and reputation.
- Financial stability and profitability.
- Credit history and repayment behavior.
- Quality of management.
- Adequacy of collateral.
- Business risks and market conditions.
- Compliance with banking policies and regulations.

Importance of Banker's Opinion

- Helps decide whether to approve or reject a loan application.
- Determines suitable loan terms and conditions.
- Reduces the risk of bad debts.
- Provides an informed basis for credit decisions.

Prudential Norms in Lending

Prudential norms in lending are guidelines and standards established by financial regulators to ensure that banks and financial institutions follow safe and sound lending practices. These norms help maintain financial stability, control credit risk, and prevent excessive losses from bad loans.

Objectives of Prudential Norms

- Ensure responsible lending practices.
- Reduce the risk of loan defaults.
- Maintain the financial health of banks.
- Improve transparency and accountability in lending operations.

Key Prudential Norms in Lending

1. Asset Classification Norms

Loans are classified based on their repayment status:

- ✓ **Standard Assets:** Loans where repayment is regular and risk is low.
- ✓ **Non-Performing Assets (NPAs):** Loans where interest or principal payments are overdue beyond the specified period.
- ✓ **Sub-standard, Doubtful, and Loss Assets:** Categories indicating increasing levels of credit risk.

2. **Income Recognition Norms**

- ✓ Banks must recognize income from loans only when it is actually received.
- ✓ Interest from non-performing loans is generally not recorded as income until collected.

3. **Provisioning Norms**

- ✓ Banks must set aside funds to cover potential losses from bad loans.
- ✓ Higher-risk loans require higher provisions.

4. **Capital Adequacy Requirements**

- ✓ Banks must maintain sufficient capital to absorb potential losses.
- ✓ Ensures that banks remain financially stable during periods of stress.

5. **Exposure Limits**

- ✓ Banks must limit the amount of credit extended to a single borrower or group of borrowers.
- ✓ Prevents excessive concentration of lending risk.

6. **Loan Documentation and Security**

- ✓ Proper documentation, verification, and security arrangements are required before granting loans.
- ✓ Protects the lender's legal rights.

7. **Credit Monitoring and Review**

- ✓ Banks must regularly monitor borrowers and review loan performance.
- ✓ Early identification of repayment problems helps reduce losses.

8. **Risk Management Practices**

- ✓ Banks must assess credit risks and establish internal controls.
- ✓ Includes credit appraisal, risk rating, and loan approval procedures.

Credit Sanction Process

The **credit sanction process** is the procedure followed by a bank or financial institution to evaluate, approve, and authorize a loan or credit facility after assessing the borrower's eligibility, risk profile, and repayment capacity.

Steps in the Credit Sanction Process

1. **Loan Application Submission**

- ✓ The borrower submits a loan application along with required documents.
- ✓ Documents may include identity proof, income records, financial statements, business details, and collateral documents.

2. **Credit Appraisal**

- ✓ The lender evaluates the borrower's:
 - Credit history and credit score.
 - Income and repayment capacity.
 - Financial position.
 - Business performance (for commercial loans).
 - Purpose of the loan.

3. **Credit Investigation**

- ✓ The bank verifies the information provided by the borrower.
- ✓ It checks references, credit records, financial documents, and other relevant details.

4. **Risk Assessment**

- ✓ The lender analyzes potential risks associated with the loan.
- ✓ Factors such as borrower reliability, industry conditions, collateral value, and market risks are considered.