Daffodil Institute of Information Technology (DIIT)

First Year, Second Semester

Bachelor of Business Administration (BBA)

Theory and Practice of Banking

Chapter-4

CREDIT MANAGEMENT POLICIES

Credit Management Policies: Credit management: its contents & meaning, loan vs. investment, Types of bank's loan, Bank's demand deposits, Credit analysis, Approaches of credit analysis, Credit worthiness of banking, Loan structure & documentation, Perfecting claim against loan security, Types of security, Deciding the suitable security, Distressed loan, Indicators of troubled loan, Bank's response to distressed loan, Sources of credit information, loan pricing, Loan pricing techniques, Loan classification as per regulatory requirements, contents of sound lending policies.

1. What do you mean by credit?

Credit: Credit is generally defined as a contractual agreement in which a borrower receives something of value now and agrees to repay the lender at a later date, generally with interest.

Both loans and lines of credit let consumers and businesses to borrow money to pay for purchases or expenses. A loan is a lump sum of money that is repaid over a fixed term, whereas a line of credit is a revolving account that let borrowers draw, repay and redraw from available funds.

Bank credit is the total amount of funds a person or business can borrow from a financial institution. It includes credit cards, mortgages, car loans, and business lines of credit.Bank credit may be secured or unsecured.

2. What is credit Management?

Credit management: Credit management is the process of granting credit, setting the terms it's granted on, recovering this credit when it's due, and ensuring compliance with company credit policy, among other credit related functions. Ensuring an adequate allowance for doubtful accounts is kept by the company.

The Credit Management function incorporates all of a company's activities aimed at ensuring that customers pay their invoices within the defined payment terms and conditions. Effective Credit Management serves to prevent late payment or non-payment.

Effective credit management is a comprehensive process consisting of:

a) Determining the customer's credit rating in advance
b) Frequently scanning and monitoring customers for credit risks
c) Maintaining customer relations

d) Detecting late payments in advance
e) Detecting complaints in due time
f) Preventing any bad debt from arising

3. What do you mean by loan?

Loan: Loan is defined as to give someone money that will be repaid with interest. Loan is an arrangement in which a lender gives money or property to a borrower, and the borrower agrees to return the property or repay the money, usual along with interest, at some future point in time.

According to Signoriello, Vincent J., "A loan is the lending of money from one individual, organization or entity to another individual, organization or entity."

4. Describe the features or characteristics of loan.

Loan is defined as to give someone money that will be repaid with interest.Loans havethe following distinguishing characteristics:

a) Parties: There are two parties involved in the loan transactions. One is thelender and other is borrower of loan.
b) Time to maturity: Time to maturity describes the length of the loancontract. Loans are classified according to their maturity into short-term debt,intermediate-term debt, and long-term debt.
c) Loan amount: Loan amount may be small, medium or large on the basis of the quality and capacity of the borrower and purpose for which applied.
d) Ultimate decision: Lenders decision is final in case of loan. That is lender can fully sanction, partially sanction or may totally reject the loan.
e) Mode of loan: Generally loans are given in cash. But in exceptional cases, the same may be provided in kind, such as raw materials, machineries etc.
f) Nature of distribution: Generally lender disburse loan in instalmentbasis. But when lender is convinced, it may disburse the whole amount of sanctionedamount at a time.
g) Process or disbursement: Lender often disburse their loan against theexisting current account of the client.
h) Securing: Generally loans are provided against collateral. But sometime Small amount of loans can be sanctioned on the basis of personal guarantee.
i) Interest: Interest is the cost of borrowing money. Lender generally sanction loan with interest. But interest rate can vary on the basis of types of loan or track recordsof the clients.
j) Periodicity: Depending on types of loan, goodwill of the clients andpurpose, periodicity of the loans can vary. Loan may be sanctioned for immediateuse, short term, and mid-term or long term basis.
k) Repayment of Loan: Loans are repaid on instalment basis or it may be aone-shot arrangement.

5. **Differentiate between loan and investment.**

Particulars	Loan	Investment
Definition	Loan is defined as to give someone money that will be repaid with interest.	An investment is an asset that will generate income in the future.
Nature	Loans are liabilities.	Investments are assets.
Contracts	Direct.	Indirect.
Period	Depends upon lender and receiver of loan.	Depends upon type of instruments.
Transaction	It is transaction of debt.	It is mostly related with securities transaction.
Parties	There are two parties i.e. lender and borrower.	There is only one party that is Investor.
Outcomes	Interest is the outcome loan.	Profit or loss is the outcome of investment.
Termination	Termination depends on borrower	Termination depends on investment policy.

6. **What do you mean by advances?**

An advance is a credit facility that is provided to an individual or corporation by the financial institution, bank, employer, friend, relative etc. Advances are generally granted by the banks to meet short-term financial requirements. Advances are commonly taken on an employee's salary. For example, an employee who receives a weekly salary for $1000 may request a $500 advance (on his next week's salary) to be paid now. The employer will then pay the employee $500 next week instead of the $1000.

7. **What are the different types of bank advance?**

Different types of bank advance:

a) **Short term loan:** The entire amount is given to the borrower at one time
b) **Overdraft:** A provision by the bank, wherein the customer can overdraw money from his/ her account until a specified limit.
c) **Bill purchase:** Advances granted by the bank upon pledging the bills.
d) **Cash credit:** A provision by the bank, wherein a customer can advance money up to an asset pledged.

8. Distinguish between loan and advances.

Particulars	Loans	Advances
Meaning	Funds borrowed by an entityfrom another entity, repayableafter a specific period carryinginterest rate is known as Loans.	Funds provided by the bank to anentity for a specific purpose, tobe repayable after a shortduration is known as advances.
Nature	A loan by nature is a debt.	Advances are by nature a credit facility.
Time duration	Loans are generally for a long term.	Advances are for short term, maximum for one year only.
Legal formalities	There are legal formalities while granting a loan.	There is low legal formalities as compared to the loan.
Collateral security	A loan is may be secured against collateral security or not.	Advances are facilitated only against primary security or any type of guarantee.
Example	Auto loan, Personal loan, Education loan, Home loan etc.	Short term loan, Overdraft facility, Cash credit, Bill purchased etc.

Or. **Distinguish between loan and advances.**

Loan

a) A loan is an amount lent by the lender to the borrower for a definite purpose for a particular time period.

b) So a loan is one kind of debt provided by a bank to fulfil the long term requirement of a borrower.

c) A lender charges a fixed rate of interest applicable to the loan amount borrowed.

d) A loan credit on the basis of borrower's income, credit history, financial transactions etc.

e) A loan may be a granted against any type of security like collateral security, mortgage asset, pledge etc. and it is called a secured loan, while nothing is put as security it is called unsecured loan.

f) An interest is generally paid on a monthly basis.

g) A loan is generally repaid in equal monthly instalments or the repayment of full amount when the expiry of loan ends along with interest payable on the loan. It depends upon the borrower which option to choose to repay a loan.

Advances

a) An advance is a credit facility provided to the big corporations to fulfil their daily needs like salary and wages, admin expenses, material expenses etc.
b) A businesses use this credit facility to run a day to day operations smoothly.
c) Advances are for the short term like for one year.
d) Banks or financial institutions charge a low-interest rate and that is why it is cheaper and convenient for businesses to use it.

9. What are the types of bank loan and advance?

There are different types of bank loans. They are mainly classified on bases of following categories.

1. **On the basis of object or purpose:**
   a) **Commercial Loans:** This loan is taken, to meet short term requirement of capital e.g., working capital.
   b) **Consumer Loan:** This loan is taken to finance household goods like fridge, T.V., scooter etc.
   c) **Agricultural Loan:** Such a loan is taken by the farmers to meet their short term requirements like buying seeds, fertilizers, insecticides etc.
2. **On the basis of Time**
   a) **Short Term Loan:** Such a loan is taken for a period of less than one year. For example, to meet working capital requirements.
   b) **Medium Term Loan**: Such a loan is taken for a period ranging from 1 year to 3years. For example, to purchase equipment for professionals or furniture etc.
   c) **Long Term Loan:** Such a loan is taken to meet long-term requirements from 3 years to 20 years or more. For example, loans to purchase land, building, plant and machinery etc. however, banks provide long-term loans to a very limited extent only.
3. **On the basis of Security**
   a) **Secured Loan:** Such a loan is granted on the security of tangible assets. A secured loan or advance as a loan or advance, made on the security of assets, the market valueof which is not at any time less than the amount of such loan or advance.
   b) **Unsecured Loans:** Such a loan is granted without any security.The loan which has no asset/ collateral to be pledged. Comes with a greater interest rate as compared to a secured loan.
4. **On the basis of form**
   a) **Loan:**Loan is defined as to give someone money that will be repaid with interest. Loan is an arrangement in which a lender gives money or property to a borrower, and the borrower agrees to return the property or repay the money, usual along with interest, at some future point in time.
   According to Signoriello, Vincent J.,"A loan is the lending of money from one individual, organization or entity to another individual, organization or entity."

b) **Cash credit:**Cash credit is an arrangement by which the customer is allowed to borrow money up to a certain limit known as the cash credit limit. Usually the borrower is required to provide security in the form of pledge or hypothecation of tangible securities. This is a permanent arrangement and the customer need not draw the sanction amount at once but draw the amount as when required. Interest is charged only for the amount withdrawn and not for the whole amount approved. Cash credit are most favourable mode of financing by large commercial and industrial concerns. Cash credit facilities is made only to the business.

c) **Overdraft:** Overdraft is an arrangement between a banker and his customer by which allowed to withdraw over and above his credit balance in the current account up to an agreed limit. This is only a temporary accommodation usually granted against security. The interest is charged only for the amount drawn and not for the whole amount sanctioned. Temporary overdrafts are permitted only where reliable source of funds are available to a borrower for repayment. Overdraft facilities can take by the individual customer.

10. Distinguish between secured loan and unsecured loan.

The following are the major differences between a secured loan andunsecured loan.

Particulars	Secured Loan	Unsecured loan
Meaning	The loan which is secured by an asset is known as a secured loan.	Unsecured loan is the loan in which there is no asset mortgaged as security.
Guarantee	In a secured loan there is a guarantee.	There is no guarantee In the case of an unsecured loan
Basis	Collateral.	Creditworthiness.
Pledging of asset	Pledging of asset is required.	Pledging of asset is not required.
Risk of Loss	Risk of Loss is less.	Risk of Loss high.
Period	Long period	Short period
Expensive	No, due to low interest rates	Yes, because the interest rate is high.
Borrowing limit	Borrowing limit is high.	Borrowing limit is comparatively less.
Right of lender in case borrower fails to pay.	Forfeit the asset.	Can sue him for the money.

11. Distinguish between cash credit and overdraft.

The following points are noteworthy so far as the difference between cash credit and overdraft is concerned.

Points	**Cash Credit**	**Overdraft**
Definition	An arrangement where the customer	A loan in which the account is

	borrow money up to a certain limit.	allowed to go into debit usually up to a specified amount.
Duration	Though it is a short term loan Sometimes it is provided for mid-term of periods.	Overdraft is always provided for a shortterm period.
Guarantee	Cash credit is provided against pledge of hypothecation of goods.	This is granted against securities.
User	Cash credit is allowed to the businessman.	Overdraft is allowed to the current account holders of the bank.
Repayment	The loan may be repaid in instalments or at the expiry of certain period.	The borrower is permitted to repay any number of times.
Purpose	For increase the current capital.	For meet the cash demand.

12. What is bank's demand deposit?

A demand deposit account consists of funds held in a bank account from which deposited funds can be withdrawn at any time, such as checking accounts. DDA accounts can pay interest on a deposit into the accounts but aren't required.

Demand deposits provide the money consumers need for purchasing daily expenses, where funds can be withdrawn at any time from the depository institution.

People deposit their savings in banks. They can withdraw their money whenever required. Because the deposits in the bank account can be withdrawn on demand, these deposits are called demand deposits.

Benefits of deposits with banks are as listed below:

- **a)** Apart from money being safely kept in the banks, people are also paid interest on the amount of money deposited in their bank account.
- **b)** Deposits also act as direct money in case of cheque payments. Cheques against a deposit settle payments without the use of direct cash.

13. What is credit analysis?

Credit analysis is the process of determining the ability of a company or person to repay their debt obligations. In other words, it is a process that determines a potential borrower's credit risk or default risk.

Credit analysis is the method by which one calculates the creditworthiness of a business or organization. A bank may analyse the financial statements of a small business before making or renewing a commercial loan.

14. What are the approaches of credit analysis?

There are two types of approach of credit analysis such as traditional approach and modern approach.

Traditional approach: Banks relied on subjective methods to evaluate the creditworthiness of their clients. The methods focus on the character of the borrower, and the credit analyst is required to assess the level of credit risk associated with lending to the borrower. The traditional approach evaluates the main characteristics of the borrower, commonly referred to as the 5 C's of Credit. An analysis that is based purely on the characteristics of the borrower is subject to human error and misuse. Banks continue to rely on traditional credit analysis approaches when evaluating potential borrowers.

Modern approach: Modern credit analysis approaches are based on qualitative credit scoring systems. In such an approach, credit analysts use the univariate accounting-based credit scoring systems to compare key accounting ratios of specific clients versus industry ratios to show how a client's ratio differs from the industry standards or trends.

Credit scoring systems assign scores to several aspects associated with the creditworthiness of a borrower. The scores can range from 300 to 850, with the latter being the highest credit rating that a borrower can get. The key aspects of a borrower that determine their credit score include payment history, current debt, length of debt, type of debt, and the payment interest. A bank can establish its own credit scoring system or use third party services.

15. What is creditworthiness?
Creditworthiness: Creditworthiness is a lender's willingness to trust you to pay your debts. A borrower deemed creditworthy is one a lender considers willing, able and responsible enough to make loan payments as agreed until a loan is repaid.

16. Describe the credit worthiness of banking.
Or. Describe the 5C's of credit worthiness.

The five Cs of credit is a system used by lenders to gauge the creditworthiness of potential borrowers. The system assesses five characteristics of the borrower. The five Cs of credit are character, capacity, capital, collateral, and conditions. The Five C's are the basic components of credit analysis. They are described here to help you understand what the lender looks for.

1. Capacity: Capacity to repay is the most critical of the five factors, it is the primary source of repayment - cash. The lender will consider the cash flow from the business, the timing of the repayment, and the probability of successful repayment of the loan.
2. Capital: Capital is the money you personally have invested in the businessand is an indication of how much you have at risk should the business fail.
3. Collateral: Collateral or guarantees, are additional forms of security you canprovide the lender. Giving a lender collateral means that you pledge an asset youown, such as

your home, to the lender with the agreement that it will be therepayment source in case you can't repay the loan.

4. **Conditions:** Conditions describe the intended purpose of the loan. The lenderwill also consider local economic conditions and the overall climate, both within your industry and in other industries that could affect your business.
5. **Character:** Character is the general impression you make on the prospective lender or investor. The lender will form a subjective opinion as to whether or not you are sufficiently trustworthy to repay the loan or generate a return on funds invested inyour company.

17. What do you mean by loan structure?

Loan structuring is simply designing the loan to fulfil the financing requirements of the borrower while simultaneously attempting to protect the lender against loss resulting from the failure of the borrower to repay the debt and the interest and fees thereon.

It is the way in which the loan product is set up to accommodate the borrower's best interest, either in short, medium or longer terms depending on the client's end goal, because we have to remember the goal of the loan is to secure a property, so a loan/debt product is really a short term means to a bigger end goal dream.

Loan can be structured based on the following categories:

1. **Based on Security**
   a) **Secured Loan:** The loan which is backed by collateral.
   b) **Unsecured Loan:** The loan which has no asset/ collateral to be pledged. Comes with a greater interest rate as compared to a secured loan.
2. **Based on Repayment**
   a. Time Loan: The entire amount of the loan (including interest) which is paid at a future specified data.
   b. Instalment Loan: A series of small amounts (each payment includes a part of interest and lent amount) distributed over a period. The amount can be either evenly distributed or as mentioned in the contract.
   c. Demand Loan: The amount along with the interest is paid back to the lender upon his request or 'demand'.
3. **The basis of the purpose of such loans can be**
   a) Car Loan
   b) Home Loan
   c) Education Loan
   d) Commercial Loan
   e) Personal Loan

18. What do you mean by loan documentation?

These are the documents required to avail a loan.

Personal Loan Documents Required Checklist	
Photo Identity Proof (any one)	Voter ID Card / Passport / Driving License.
Residence Address Proof (any one)	Ration Card / Passport / Utility Bill.
Income Proof	Last 3 months Payslip & Bank Statement of last 3 months.
Job Continuity Proof	Job Offer Letter / Letter from the HRD (if current employment less than 2 years).
Financial Documents	a. **Salaried Individuals:** Latest 3 month's Salary Slips and Form 16, Bank Statements of 6 months. b. **Self Employed Individuals:** Latest 1 year bank statement for both savings and current account.
Photo	1 passport size colour photograph
Application Form	Personal Loan Application Form duly filled.

19. What is perfecting claim against loan security?
A perfecting claim is a binding document that has been filed with the appropriate agency allowing for a legal claim to seize assets if a payer defaults. Commonly, a perfected lien is enacted for the purpose of legally securing collateral for a creditor in a secured loan.

20. Define security. Discuss the characteristics of security/ deciding the suitable security.
Security: Security is a tradable financial asset use to guaranty the repayment of a loan. Security is what the borrower puts up to guarantee repayment of the loan. It may include tangible, intangible assets or even personal guarantee.

According to Business Dictionary, "Security is an asset pledged to guaranty the repayment of a loan, satisfaction of an obligation, or in compliance of an agreement."

The Economist defines security as, "Something of value given to a lender by a borrower to support his or her intention to repay.

Characteristics of security:

1. Marketability: The security taken must be readily sale-able with the minimum of expenses. The banker should prefer essential goods, industrial raw materials and other manufactured goods having ready marketability for the purpose of collateral.

2. Easy ascertainment of value: The security must be capable of being valued with ease.

3. Stability of price: The value of security must be fairly stable. Banker must also make sure that value of the security does not fluctuate violently over short periods.

4. Easy storability: Where goods are pledged, the banker must keep them under his custody when it is possible for him to supervise. Some goods are easilystorable and do not require special storage facilities and they satisfy the condition of easy storability.

5. Durability: A security should be reasonably durable. Perishable commodities like vegetable, fruits, fish as securities. Some of the commodities like chilies, woollen garments etc. require special care in storage; otherwise they depreciate in quality and value.

6. Transportability: A security should be of such a nature that it can be moved from one place to another without much difficulty.

7. Cost consideration: Certain securities are very costly to keep.

8. Ownership: Before accepting any security the banker must ensure the ownership of the property.

9.Acceptability: The asset accepted as a security must be acceptable in the eyes of the general law.

10. Documentation: The proper documentslike mortgage and so on must be observed by the bankers.

11. Financial Ability: The banker must query the financial soundness of the guarantor.

21. Discuss the different types of securities charged by the bank.

1. Pledge:Pledge is a bailment of **goods** as security for payment of a debt or performance of a promise.
   The person who offers the security is called the pawnor or 'pledger and the bailee is called the 'pawnee' or the 'pledgee'.
   Delivery of goods from one person to another for somepurpose upon the contract thatthe goods will be returned back when the purpose is accomplished or otherwisedisposed of according to the instructions of the bailor.From the above definitions we observe that,
   A pledge occurs when goods are delivered for getting advance.The goodspledged will be returned to the owner on repayment of the debt.The goods serve as a security for the debt.

2. Mortgage: A mortgage is the transfer of all interest in specific **immovable property** tor the purpose of securing the payment of money advanced orto advance by way or loan, an existing or future debt, or the performance of anengagement which may give rise to a pecuniary liability.
   In terms of the definition, the following are the characteristics of a mortgage
   A mortgage can be affected only on immovable property. Immovable propertyincludes land, benefits that arise out of things attached to the earthbuilding.
3. Hypothecation: The mortgage of movable property for securing loan iscalled hypothecation. In other words, in case of hypothecation, a charge over **movableproperties** like goods, raw materials, and goods-in-process is created.
   Hart defines hypothecation as "a charge against property or an amount where neitherownership nor possession is passed to the creditor"
   According to Hart when goods are made available as security for a debt withouttransferring the possession of property to the lender, the transaction is ahypothecation.
   The goods remain with the borrower under a hypothecation agreement heundertakes to transfer the possession whenever required to do so.
4. Assignment:Assignmentmeans transfer of any existing or future right,property, or debt by one person to another person. The person who assigns theproperty is called 'assignor and the person to whom it transferred is calledassignee. Usually assignment are made of actionable claims such as book debts, insurance claims etc. In banking business a borrower may assign to the banker:
   a. Book debt
   b. Money due from government
   c. Insurance policy

22. What is definition of mortgage?
A mortgage is a loan in which property or real estate is used as collateral / security. Inbroad sense, a mortgage is the transfer of an interest in specific **immovable property** for the purpose of securing the payment of money advanced or to be advanced by way of loan, and existing or future debt or the performance to an engagement which may give rise to a pecuniary liability.

Finally we can say that mortgage is a legal agreement that conveys the conditional right of ownership on an asset or property by its owner (the mortgagor) to a lender (the mortgagee) as security for a loan.

23. Define problem loan.
A problem loan is a loan that the borrower cannot or is unwilling to repay according to the original loan agreement.
In the banking and credit markets, a problem loan is one of two things: It can be a commercial loan that is at least 90 days past due or a consumer loan that is at least 180 days

past due. In either case, this type of loan is also referred to as a nonperforming loan, troubled loan, sour loan.

Indicators of troubled loan:
There are several warning signals: thin margins, liquidity questions, adverse business and employment conditions, insufficient (under margin) collateral, insufficient income.

24. What are the indications of problem loan/ troubled loan in Bangladesh

For identifying the "potential" problem loans, we have to know the symptoms of problem loan. In Bangladesh the indication of problem loans can be classified in the following way:

Quantitative Indicators

1. Preparation of irregular and delayed financial statements
2. Refusal of large insurance claim.
3. Creating hindrances to the main source of income
4. Diminishing deposit balance
5. Inability to pay the debt of creditors other than the bank.
6. Non-repayment of the loan instalments as repayment dates.
7. Entering into big loan contracts frequently with institutions and persons other than theexisting bank.
8. Continuous decline in the market price of the shares of the borrowing company.
9. Sudden rise or fall of large size deposit withdrawals.
10. Excessive cash dividend pay outs from reserve fund or even from capital.
11. At the end of the cycle, creditors are not completely paid out.
12. Concentration changes from a major well-known customer to one of lessone of lesser stature.
13. Loans are made to or from officers and affiliates.
14. Unable to clean up bank debt, or clean-ups are affected by rotating bank debt
15. Investment in fixed assets has become excessive.

Qualitative Indicators

1. Sudden death or accident of chief executive of the business
2. Avoiding communication with the lending bank.
3. The borrowing organization is not operating smoothly due to some conflicts amongthe executives and among the board members.
4. Bitter relationship between borrower and lending bank.
5. Occurrence of theft, fraud, robbery and/or hijacking in the organization of theborrowers.
6. Conflicts among the heirs of the owners of the borrowing organization.
7. Pretending in the manner that payable are paid.
8. Financial reporting is frequently down-tiered due to changes financialmanagement
9. Delayed responses of financial transaction.

10. Suppliers cut back terms or request cash on Delivery (COD).
11. Distribution or production methods become obsolete.
12. The company has grown dependent on trouble customers or industries.
13. The board of directors is no longer active in making crucial business decisions.
14. Lack of depth in managerial decision making.
15. Financial control mechanisms are weak.

Qualitative indicators as well as quantitative indicators provide valuable informationabout the problem or make repeat requests of increasinginstalment date.

25. What is distress loan?

A **distressed** borrower is a borrower who is unable to fully repay their debt on time, due to financial difficulties. A **distressed** borrower can be either a person or a business whose income falls due to unforeseen circumstances. The situation may invoke a collection agency.

26. How does a banker handle problem loan? /Bank's response to distressed loan.

Handling of problem loan: The main responsibility of bank manager and loan officer is to recovery the outstanding loan. The recovery procedures are-

- **a)** Usual procedure
- **b)** Legal procedure

a) Usual procedure: The usual loan recovery procedure is divided into several steps. They are as follows:

1. Issue of demand notice: Demand notice is issue before onmonth being due of outstanding loan or instalment. It is sent to the borrower.
2. Legal notice: It the borrower does not repay their respective loansand interest after maturity being received the demeaned notice under registeredwith acknowledgement by post to the borrowers the bank should send lowernotice to him.
3. Special notice: Beside the above to notice a special notice signatureby DC, TNO is sent to the respective borrower to keep mental pressure on himfor repaying the loan.
4. Field recovery: Loan officer recover the recovered loan through I.O. receipt by visiting the spot and source of the borrower.
5. Personal Communication: If the borrower fails to repay his loaninstalment, the loan officer communicates with the respected personsthatarea to give mental pressure to the borrower so that he repays his respective loan.
6. Loan Recovery Camp: Bank made camp in various areasfor therecovery of his loan, in this issue; the manager and other officer were present inthe camp and communicated with borrowers. They gave them moral persuasionand tried to encourage them, so that they could repay their loan.
7. Interest exemption: Loan recovery with the help of interestexemption the loan amount which becomes more than double in principle andinterest and which is not

possible to recover with the help of legal action thenthose loan can be recovered by exempting interest. By this way bad loan can berecovered.

b) **Legal procedure:** When bank failed to recover the loan by the help ofusual procedure bankers take the help of the law. Collection of debt by the law iscalled legal procedure.

27. What are the sources of credit information?

Loans are sanctioned on the basis of loan application. Loan cases are merely observing the loan amount or the purposes petitioned in the loan application form. Rather bank examines whether the purposes or loan are acceptable to banks. This consideration is made to ensure the return of loan amount.

In the following we may we may find the usual sources of credit information.

A. Internal sources
B. External sources

These-sources are described below:

A. Internal sources

1. Application:Bankers may information of the client by analysing the filled in credit application form.
2. Interview:A banker can also get information by interviewing or directly contracting with the clientand ask him/her the reasons of seeking credit.
3. Financial statement:If any business firm wants to take loan from the bank, it has to submit its financialstatements. From the financial statements, banks can get information regarding the trendfinancial position of the firm.
4. Bank's own record: If the client had previous transactions with the bank, bank can get information of the client from the document/ records kept in the bank.

B. External sources

1. Government or regulatory authorities:Government sets and establishes rules and regulation for controlling the businessactivities of the country. Govt. may serve as the source of required information.
   a. Income tax office:If bank wants to know information regarding the tax payment by the potential borrower, it may seek information from the income tax office.
   b. Government gazette: Bank can get periodic information if had any Govt. contract from the published gazette,by the government.
   c. Records from the other govt. office: Bank can get other information regarding the potential borrower from relevant othergovernment offices with which the loan applicant had moved around for business connection.
   d. Registrar of joint stock companies:If necessary bank may seek information about the client form joint stock registrar'soffice.
2. Other sources:
   a. Inspection: Bank may send one of its officials to Visit physically and inspect the potential or owners working place or factory.

b. Market report: Banks may analyse the market potentiality or the business of the client from the report of the stock markets.
c. Credit information bureau: CIB preserves the loan information of large business organization or people those frequently approach for loans.
d. Newspaper: Bank may carefully analyse newspaper reports as appear in the commercial/ financial page to find information regarding the potential borrower.Sometimes in newspaper, exceptional strong/ weak information regarding the clientsmay be published. This information may affect the credit worthiness of the clientpositively or negatively.

28. What is loan pricing?

Loan pricing is the process of determining the interest rate for granting a loan, typically as an interest spread (margin) over the base rate, conducted by the book runners. The pricing of syndicated loans requires arrangers to evaluate the credit risk inherent in the loans and to gauge lender appetite for that risk.

28. What are the ways to price of loans?

The components of true cost of a loan are:

1. Interest expense,
2. Administrative cost, and
3. Cost of capital

The three ways to price loans are as follows:

1. Price to competition. Banks determine where competitors are charging for similar loans in the marketplace and price accordingly.
2. Cost-plus pricing. Here, banks calculate their risk, cost of capital, funding costs, all direct and indirect costs and add a margin to determine the price.
3. Perceived value to the customer. While more subjective, the bank determines the maximum a borrower will pay for the perceived value of the banker's expertise and problem that the bank is solving.

Price of the loan (Interest Rate Charge) = Base Rate + Risk Premium.

29. Describe the loan classification as per regulatory requirements.

All loans and advances will be grouped into four (4) categories for the purpose of classification, namely (a) Continuous Loan (b) Demand Loan (c) Fixed Term Loan & (d) Short-term Agricultural & Micro Credit.

(a) Continuous Loan: - The loan Accounts in which transactions may be made within certain limit and have an expiry date for full adjustment will be treated as Continuous Loans. Examples are: CC, OD etc.

(b) Demand Loan: The loans that become repayable on demand by the bank will be treated as Demand Loans. If any contingent or any other liabilities are turned to forced loans (i.e.

without any prior approval as regular loan) those too will be treated as Demand Loans. Such as: Forced LIM, PAD, FBP, and IBP etc.

(c) Fixed Term Loan: The loans, which are repayable within a specific time period under a specific repayment schedule will be treated as Fixed Term Loans.

(d) Short-term Agricultural & Micro Credit: Short-term Agricultural Credit will include the short-term credits as listed under the Annual Credit Programme issued by the Agricultural Credit and Special Programmes Department (ACSPD) of Bangladesh Bank. Credits in the agricultural sector repayable within 12(twelve) months will also be included herein. Short-term Micro-Credit will include any micro-credits not exceeding Tk.25,000/= (twenty five thousand) and repayable within 12(twelve) months, be those termed in any names such as Non-agricultural credit, Self-reliant Credit, Weaver's Credit or Bank's individual project credit.

30. What is Collateral? Discuss the different types of collateral.

Collateral is an asset or property that an individual or entity offers to a lender as security for a loan. It is used as a way to obtain a loan, acting as a protection against potential loss for the lender should the borrower default in his payments. In such an event, the collateral becomes the property of the lender to compensate for the unreturned borrowed money.

For example, if a person wants to take out a loan from the bank, he may use his car or the title of a piece of property as collateral. If he fails to repay the loan, the collateral may be seized by the bank, based on the two parties’ agreement. If the borrower has finished paying back his loan, then the collateral is returned to his possession.

Types of Collateral

In order to be able to take out a loan successfully, every business owner or individual should know the different types of collateral that can be used when borrowing.

1. Real estate: The most common type of collateral used by borrowers is real estate, such as one’s home or a parcel of land. Such properties come with a high value and low depreciation. However, it can also be risky because if the property is sequestered due to a default, it cannot any longer be taken back.
2. Cash secured loan: Cash is another common type of collateral because it works very simply. An individual can take a loan from the bank where he maintains active accounts, and in the event of a default, the bank can liquidate his accounts in order to recoup the borrowed money.

3. Inventory financing: This involves inventory that serves as the collateral for a loan. Should a default happen, the items listed in the inventory can be sold by the lender to recoup its loss.
4. Invoice collateral: Invoices are one of the types of collateral used by small businesses, wherein invoices to customers of the business that are still outstanding – unpaid – are used as collateral.
5. Blanket liens: This involves the use of a lien, which a legal claim is allowing a lender to dispose of the assets of a business that is in default on a loan.

31. Define sound landing policy.

Sound landing policy: Sound lending policy refers thelending philosophy standards and guidelines for granting a loan that its employees must observe in granting or refusing a loan. These policies determine which sector of the industry or business will be approvedand which will be avoided, and must be based on the country's relevant laws and regulations.

32. Describe the contents of sound lending policies. /What are the cardinal principles of sound lending policy?

The principles of sound lending policy: Banks have been following three cardinal principles of lending i.e. safety, liquidity and profitability. Hence banks observer both the traditional and certain other principles.

a) **Safety:** Safety first is first principle of landing policy. A bank lends whatis receives from the public as deposits. The success of the bank depends upon theconfidence of the depositing public. Safety depends upon the security of offered by the borrower and the repaying capacity and willingness of the debtor to repay theloan with interest.
b) **Liquidity:** Liquidity refers to the ability of an asset to convert into cash without loss within shorttime. The liabilities of a bank are repayable on demand or at short notice.
c) **Profitability:**Like all other commercial institutions bank are run for profit. Banks can't profit to payinterest to depositors, declare dividend to shareholders, meet establishment charges andothers expend see, provide for reserve and for bad and doubtful debts, depreciation,maintenance and improvements of property owned by the bank and sufficient resourcesto meet contingent loss.So, profit is an essential consideration. A banker should employ his funding such a waythat they will bring him adequate return.
d) **Security:** Customer may offer different kinds of securities, i.e. land, building, machinery goodand raw materials to get advances. The securities of the customers are is surname abanker can fall back upon then is times of necessity. Securities which could bemarketed easily, quickly and without loss should be preferred.
e) **Purpose of the loan:** Before sanctioning loans a banker should enquire about the purpose for which it is needed. Loans for undesirable activities such as speculation and heading should be discouraged. Borrowing for productive. Purposes are readily allowed by banks. It is also equally important on the part of banks to ensure that a loan is utilized for the purpose for which it is granted so that repayment will be prompt.

5. **Sources of Repayment:** Before giving financial accommodation a bank should consider the source from which repayment is promised. Sometimes customers may apply for loans for additional working capital for their business and under take to repay out of the profit over a period. An examination of the audited accounts may guide the banker in knowing the repayment capacity of the customer.
6. **Diversification of risk:** This means he should not lend a major portion of his loan available funds to any single borrower as to an industry as to one particular region. An adverse change in the economy of these may affect the entire business. In such a case repayment will be highly difficult and the survival of the bank becomes questionable.
7. **Recent concept of sound lending:** Today a bank is not exclusively financial institution but is alive to the needs of the people. It has a strong social objects and social conscience. Banks are catalytic agents in catering to the better needs of development in conformity with the ration objective. If rapid progress is to be realized, bank credit should of economic available to the reflected sectors of economic activity and the under privileged sections of the society.

Thank you