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INDIA'S LARGEST TEST PREP PLATFORM

Module-C Unit-5

CAIIB PAPER-1

Advanced Bank Management (ABM)

CAIIB Paper 1 (ABM) Module C Unit 5: Credit Delivery

Credit Delivery

Documentation

- The documents should be **properly stamped**
- The date of execution of documents should never be earlier than the date of stamping. **Date and place** of execution should be **properly mentioned in the documents.**
- It should be ensured that the parties executing the documents have the necessary authority and the capacity to enter into a contract and executed the documents in that capacity. **For example,** a partner should sign on behalf of the firm and not in his individual capacity.
- It should be ensured that the person signing the **documents is doing so with his free will**
- The documents should be filled in before these are signed.
- **In case of companies**, the charge should be registered with ROC. Within 30 days from the date of execution of the documents.
- **If any document is required** to be registered with the Sub-registrar, it should be done within the prescribed time limit.

Third Party Guarantees

- While the **enterprise or individual, who has taken the loan from the bank is legally bound to repay the principal and the interest**, in some cases, banks stipulate guarantees of third parties, as an additional safety against default.
- **These third parties can be individuals or any other legal entity**. In case of finance to firms, the personal guarantee of proprietor or partners is not stipulated as they have unlimited liability and their personal assets can be attached for recovery of bank loans.

Charge Over Securities

- Mortgage
- Hypothecation Pledge
- Lien
- Assignment
- Pledge

Disbursal of Loans

Working Capital Loans

In case of sole banking, the bank providing working capital limits opens a cash credit account of the borrower and all his financial transactions should be routed through this account. Without bank's permission, no account can be opened with any other bank. Banks give permission to open current account with other bank only if they are convinced about its necessity. In such cases, periodic statements of that account are obtained to keep a tab on the transactions.

With this, if the borrower wants to draw very little amount or no amount, there will be debit in the loan account (fixed amount) while the cash credit account may have credit balance. **RBI guidelines in this respect are as follows**:

- In the case of borrowers enjoying working capital credit limits of **Rs 10 crore and above** from the banking system, the loan component should normally **be 80 percent. Banks**, however, have the freedom to change the composition of working capital by increasing the cash credit component **beyond 20 percent or to increase the 'Loan Component' beyond 80 percent, as the case may be, if they so desire.** Banks are expected to appropriately price each of the two components of working capital finance, taking into account the impact of such decisions on their cash and liquidity management.
- In the case of borrowers enjoying working capital **credit limit of less than Rs. 10 crone, banks may persuade them to go in for the 'Loan System'** by offering an incentive in the form of lower rate of interest on the loan component, as compared to the cash credit component. The actual percentage of 'loan component' in these cases may be settled by the bank with its borrower clients.
- In respect of certain business activities, which are cyclical and seasonal in nature or have inherent volatility, the strict application of loan system may create difficulties for the borrowers. Banks may, with the approval of their respective Boards, identify such business activities, which may be exempted from the loan system of delivery.

Term loans

RBI guidelines in respect of disbursement of project loans are as under:

'At the time of financing projects banks generally adopt one of the following methodologies as far as determining the level of promoters' equity is concerned.

- Promoters bring their entire contribution upfront before the bank starts disbursing its commitment.
- Promoters bring certain percentage of their equity **(40% — 50%)** upfront and balance is brought in stages.
- Promoters agree, ab initio, that they will bring in equity funds proportionately as the banks finance the debt portion.

Syndication of Loans

- The term '**Syndication**' is normally used for sharing a long-term loan to a borrower by two or more banks. This is a way of sharing the risk, associated with lending to that borrower, by the banks and is generally used for large loans. The borrower, intending to avail the desired amount of loan, gives a mandate to **one bank (called Lead bank)** to arrange for sanctions for the total amount, on its behalf.
- **The lead bank approaches various banks** with the details These banks appraise the proposal as per their policies and risk appetite and take the decision. The lead bank does the liaison work and common terms and conditions

of sanction may be agreed in a meeting of participating banks, arranged by the lead bank. Normally, the lead bank charges **'Syndication fee'** from the borrower.