



對外經濟貿易大學

Chapter 9

Overview of Credit Policy and Loan Characteristics

The credit process

- The fundamental objective of lending is to make profitable loans with minimal risk.
 - Management should target specific industries or markets in which lending officers have expertise.
 - The somewhat competing goals of loan volume and loan quality must be balanced with the bank's liquidity requirements, capital constraints, and rate of return objectives.

The credit process

- Loan policy: formalizes lending guidelines
 - Credit philosophy: how much risk and the form
 - Credit culture: the fundamental principles
 - Three potentially different credit cultures:
 - Values-driven
 - Current-profit driven
 - Market-share driven
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The credit process

- The credit process includes three functions
 - Business development and credit analysis
 - Underwriting or credit execution and administration
 - Credit review

Business development and credit analysis

- Market research
- Advertising, public relations
- Office call programs
- Obtain financial statements, borrowing resolution, credit reports.
- Financial statement and cash flow analysis
- Evaluate collateral
- Line officer makes recommendation on accepting/rejecting loan
- Five Cs of good credit and five Cs of bad credit

Recent Trends in Loan Growth and Quality

- Loans account for more than 60% of the total assets
- Real estate loans represent the largest single loan category for all banks. (US: 61%, CN:10%)
- The relative importance of consumer loans has increased to 59% by 2004. (In China, 10%)
 - Contribution of consumption to GDP (US: 69%; CN: 43%)
 - Banks are their only lender
 - Safer (more dispersed)
- Loan volume and quality vary with the business cycle

Trends in Competition of Loan Business

- ❑ Banks face tremendous competition for loan business not only from other banks, but also from non-bank sources.
- ❑ The widespread use of credit scoring by lenders and the securitization of consumer and small business loans puts additional pressure on interest rates.
- ❑ The internet has also led to smaller spreads for the more standardized loan products (e.g., ALM, automated loan machines).
- ❑ Banks of different size follow different strategies.

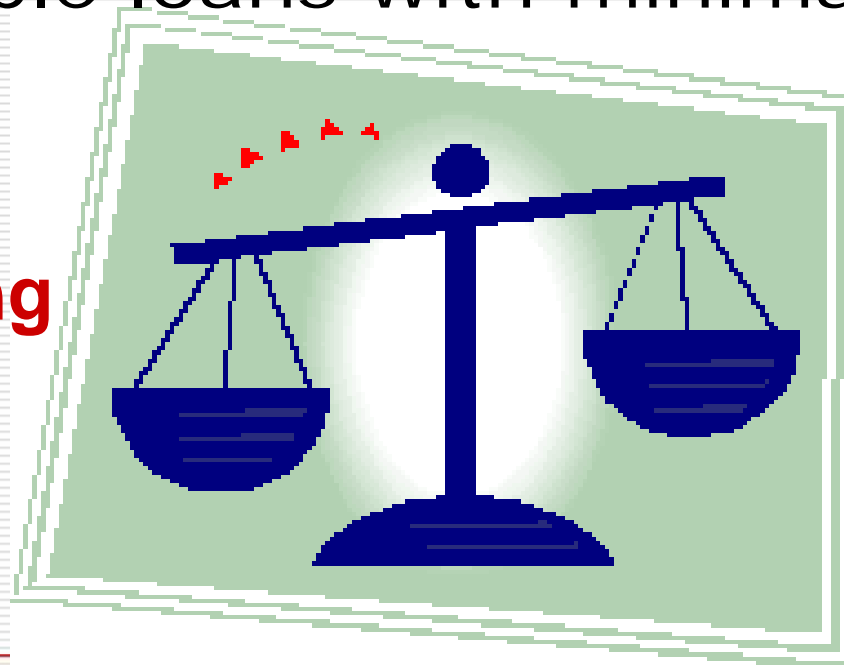
Business development

- Marketing bank services to existing and potential customers.
 - Get new customers
 - Retain current customers and cross-sell

The Credit Analysis and Management

- Alter Wriston: “The fundamental objective of lending is to make profitable loans with minimal risk.”

**Controlling
Risks**



**Grasping
Opportunities**

The Credit Analysis and Management: 13 Cs

□ Five Cs of Good Credit

- Character
- Capital
- Capacity
- Conditions
- Collateral

□ Three “Most Important” Cs

- Club
- Cocktail
- Connections

□ Five Cs of Bad Credit

- Complacency
- Carelessness
- Communication
- Contingencies
- Competition



Five Cs of Good Credit

- ❑ Character: honesty and trustworthiness
- ❑ Capital: wealth position measured by financial soundness
- ❑ Capacity: legal standing and management's expertise
- ❑ Conditions: economic environment or industry-specific factors
- ❑ Collateral: secondary source of repayment in the case of default

Additional Cs and Ps of Good Credit

□ Classical Five Cs

- Character
- Capital
- Capacity
- Conditions
- Collateral

□ Additional Cs

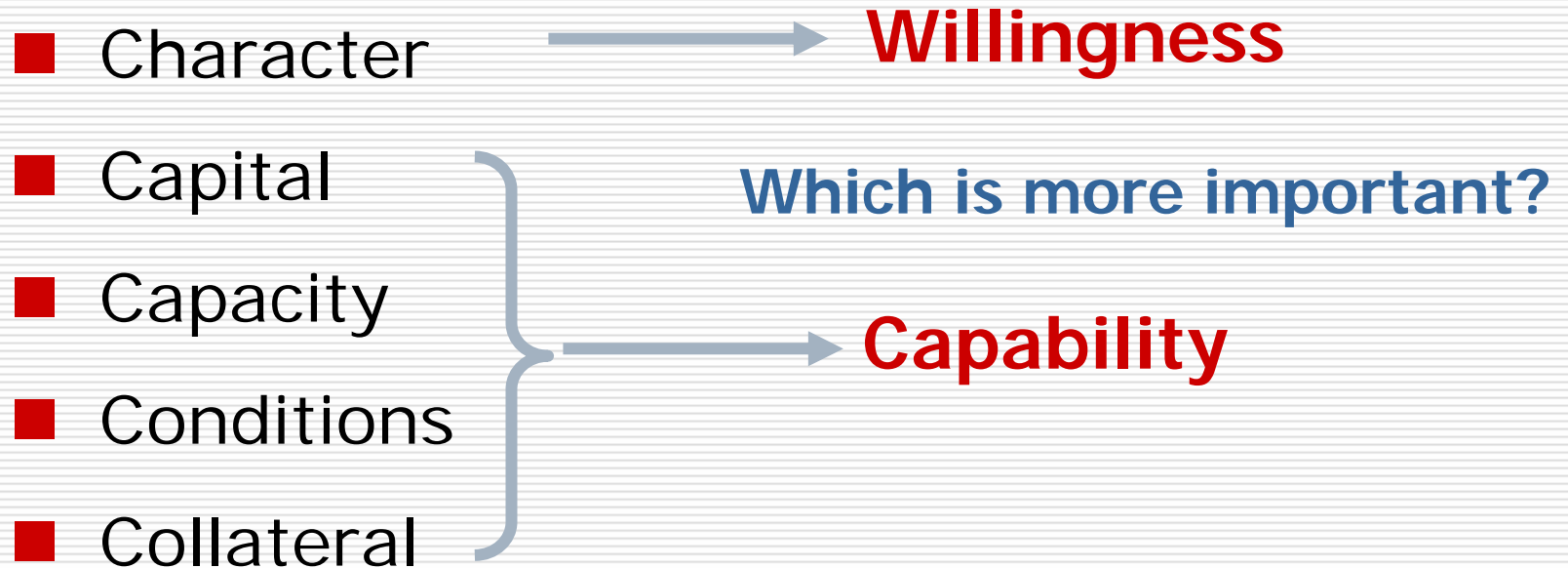
- Cash
- Control
- Continuity

□ Ps

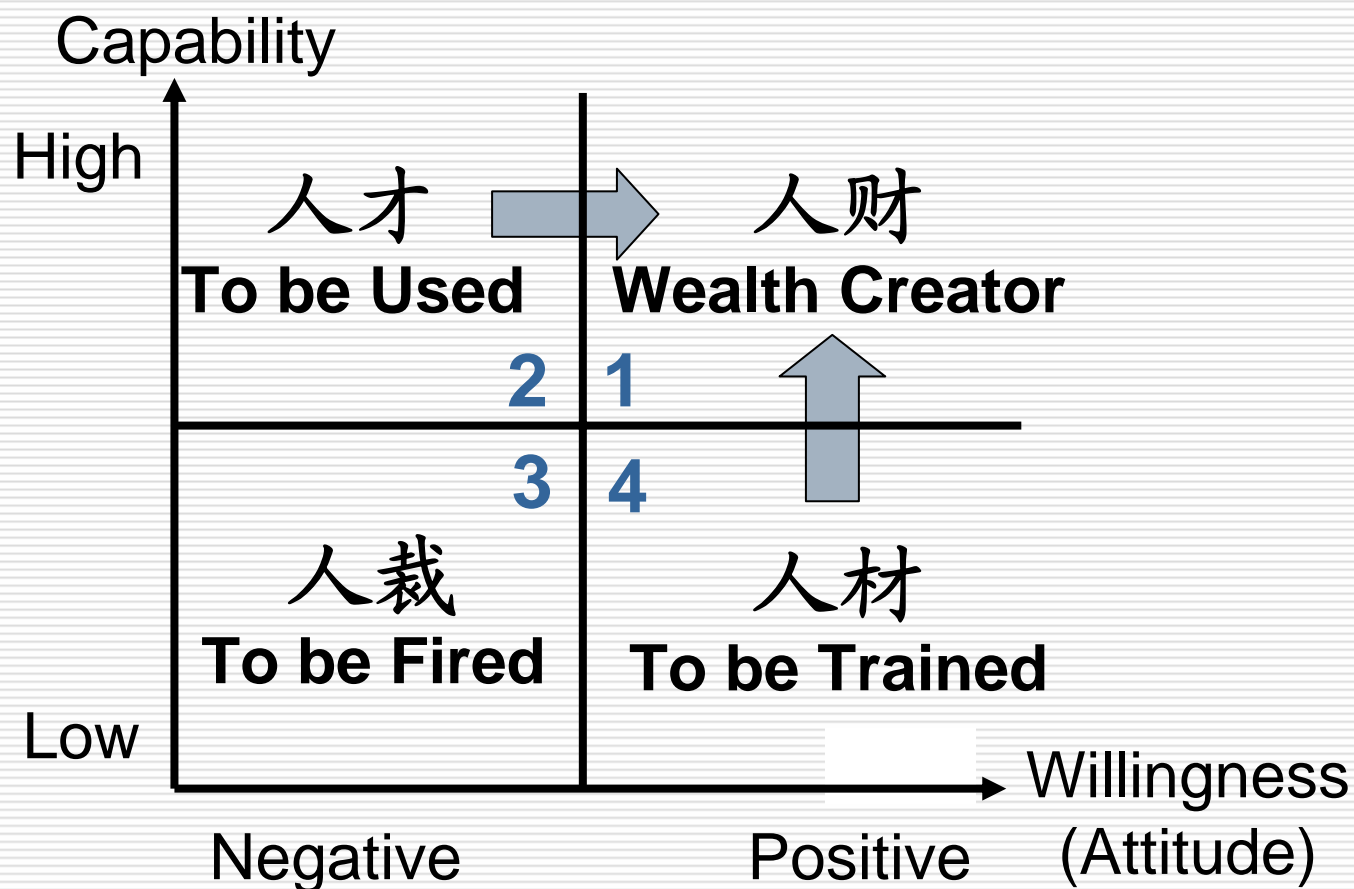
- Person (People)
- Purpose
- Payment
- Protection
- Prospect

Five Cs of Good Credit

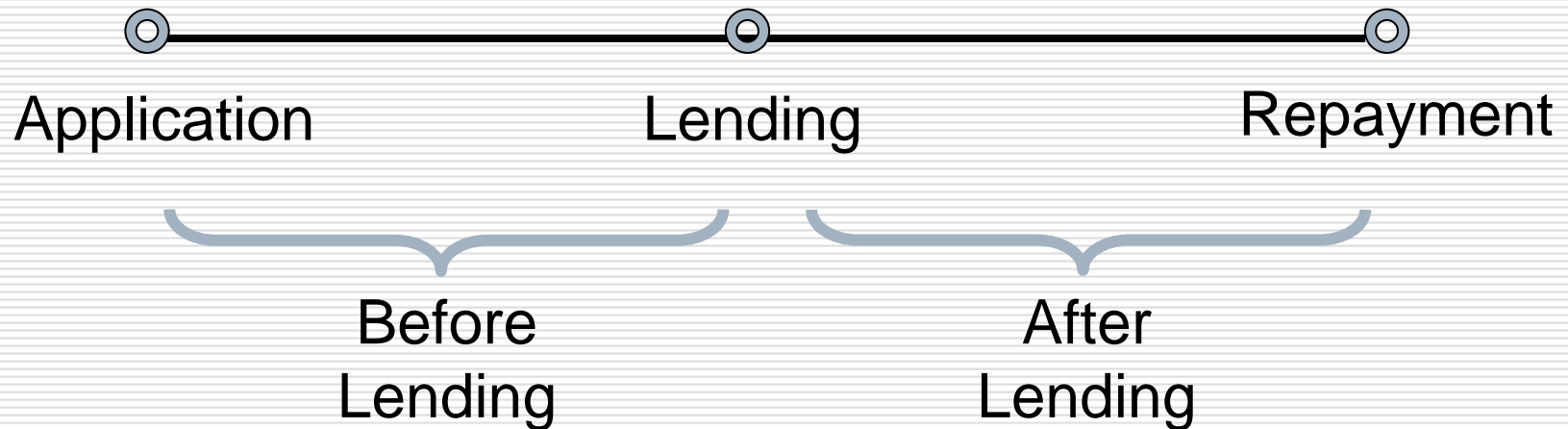
□ Classical Five Cs



In **working**, which is more important? **Willingness or Capability?**

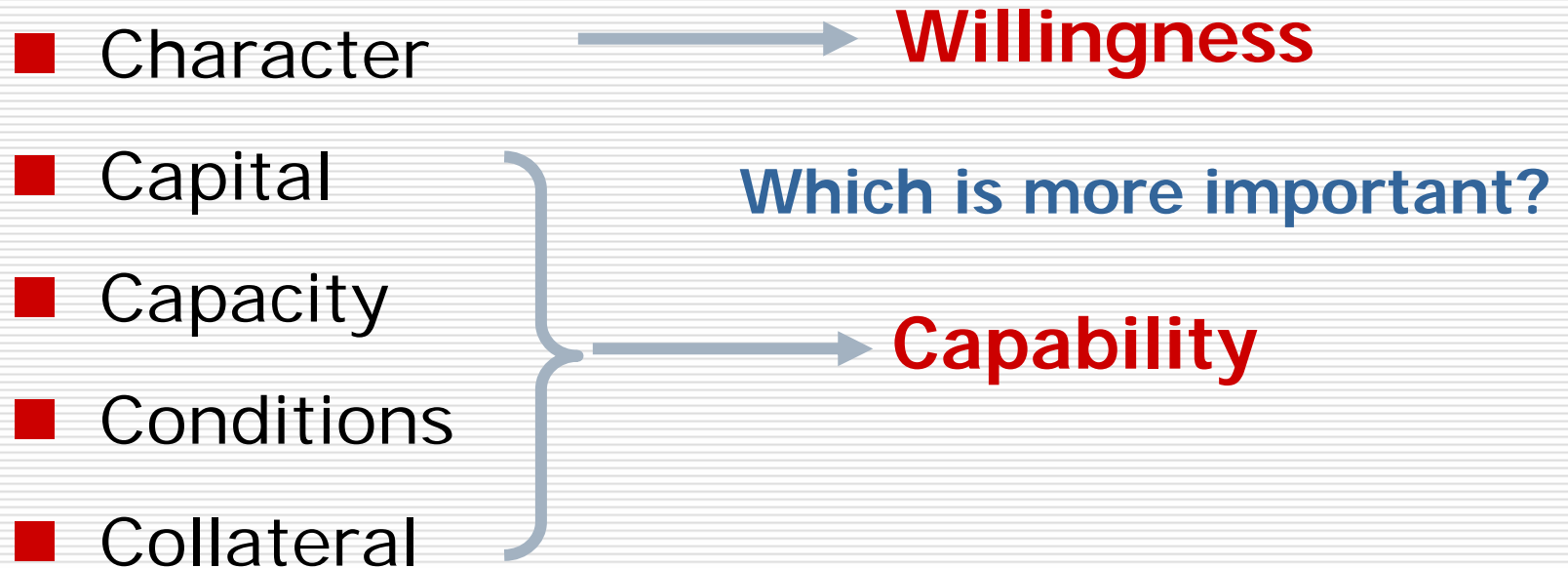


In **lending**, which is more important? **Willingness or Capability?**



Five Cs of Good Credit

□ Classical Five Cs



What is character?

- Steven Covey:
“Character is a composite of habits.”
- Aristotle: “We are what we repeatedly do. Excellence, then, is not an act, but a habit.”

How do we know the character of a borrower?

- History
- Face-to-face meeting
- Reference

Five Cs of bad credit

- Complacency
 - the tendency to assume
 - Carelessness
 - monitor a borrower's progress and identify problems as early as possible
 - Communication
 - between the bank and the borrower; within the bank
 - Contingencies
 - failure to identify downside risk
 - Competition
 - follow competitors' behavior rather than maintaining the bank's own credit standards
-

Three “Most Important” Cs

- Club
 - Cocktail
 - Connections
- **Relationship**



THE RIGHT RELATIONSHIP IS EVERYTHING.®

Credit execution and administration

- ❑ Loan committee reviews proposal/recommendation
- ❑ Accept/reject decision made, terms negotiated
- ❑ Loan agreement prepared with collateral documentation
- ❑ Borrower signs agreement, turns over collateral, receives loan proceeds
- ❑ Perfect security interest
- ❑ File materials in credit file
- ❑ Process loan payments, obtain periodic financial statements, call on borrower.

Credit review

- Review loan documentation
- Monitor compliance with loan agreement:
 - Positive and negative loan covenants;
 - Delinquencies in loan payments;
 - Discuss nature of delinquency or other problems with borrower.
- Institute corrective action
- Modify credit terms
- Obtain additional capital, collateral, guarantees
- Call loan



**Thank You Very Much for
Your Kind Attention!**



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