

Chapter 7 – Loan Disbursement

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Learning Objectives

What you should achieve after completing this chapter:

- Know all the possible documents required for different securities;
- Know what to check for in each document;
- Be able to understand the relevance of covenants contained in letters of offer and loan agreements;
- Know what to follow-up on after disbursement of the funds;
- Know the risks and controls that one needs to be aware of in relation to security; and
- Know the responsibilities and importance of the loan review function.

1. Introduction

Once documentation is completed either by the entrusted solicitor or the financial institution (FI)'s staff, the credit administration officer or compliance officer has to ensure that the documents are perfected before signing off for disbursement.

1.1 The officer

- Checks to see that title, ownership and possession of the securities are in order.
- Ensures that both lender and borrower fully understand the terms of the agreement. (It is also the role of the solicitors preparing the documents)
- Stores the documents in safe custody.

At all times the officer processing the loan should not be the officer verifying the documents and disbursing the loan. This is to maintain impartiality and objectivity in ensuring the FI's security and interest are protected.

1.2 Solicitor's role

At the time of taking legal action, third parties who offer security or guarantees sometimes file a defence stating that they had not been properly informed of the purpose of the loan for which they had offered security or guarantee. Disputes also arise when thumbprints are not properly taken and guarantees are dated on the day the guarantor was overseas although the guarantee had actually been signed on another day.

These situations arise when the documents are signed in the presence of the credit administration officer. If the documents are signed in the presence of the solicitors, it is deemed that the solicitors had explained the contents of the documents to the borrower and such disputes will not arise later. Herein lies the justification of entrusting the work to the solicitor. The solicitor will also act in the best interest of the FI in ensuring the documentation is perfected. As a general rule, the larger the loan, the more the need to entrust documentation to solicitors.

However, one should bear in mind that it is important for the FI to retain control over the format and content of standard documents such as the Deed of Charge. External solicitors should follow closely the FI's requirements.

If a FI does not perfect its security interest, it may find itself in an unsecured position, or its claim may be subsequent to an ensuing lien.

2. Pre-Disbursement

2.1 Completion of documentation

Documents as contained in the letter of offer are to be executed by the borrower, the FI's power of attorney holders, guarantors and others, and stamped and registered where applicable.

It is the lender's duty to prepare documentation. Generally, the lender relies on the solicitor to design standardised documents which if properly completed comply with all applicable regulations. The cost of preparing the documents and all legal fees in relation to the preparation of the documents are to be borne by the borrower. A documentation checklist is often included in the bank's policy manual as a reference source for lenders.

Possible documents required by financial institutions:

(a) Property Taken as Security

(i) Deed of Charge (This document is taken when the property is issued with a title deed)

- Stamped at the Stamping Office and registered at the respective land office.
- Original title deed to be in possession of the FI.
- Verification that the latest quit rent and assessment has been paid.

(ii) Memorandum of Transfer

For the transfer to be registered, the land has to be adjudicated. This is to determine the value of the land by the land office and thereafter determine the stamp duty payable on the adjudicated amount. *Ad valorem* stamp duty is payable on the principal documents and that on all other documents is nominal.

The documents are to be stamped at the stamping office as per the adjudicated amount determined by the land office.

- (iii) Loan Agreement Cum Assignment (LACA). (This document is taken when the property has not been issued with a title deed.)**
- The document is to be stamped at the stamping office.
 - The LACA is to be endorsed by the developer. This is to prevent the developer from dealing in the same piece of property when the title to the said property is issued.
 - Original copy of the sale and purchase agreement.
- (iv) Power of attorney**
- Stamped and presented for registration at the High Court. This document is sometimes prepared separately or incorporated in other documents e.g. LACA.
 - The document is to be stamped for a nominal sum.
- (v) Lien holder's caveat**
(only for the situation where the title has been issued and where owner of property is also the borrower)
- Presented for registration.
 - The document is to be stamped for a nominal sum.
- (vi) Letters of Undertaking**
- (a) From developer (where title is applicable)
To refund all loan monies to the FI in the event of:
- Non-registration at the land office for any reason whatsoever.
 - Abandonment and suspension of project.
 - Non-issuance of Certificate of Fitness for the property.
- (b) From developer (where title is not applicable)
To deliver a valid and registrable transfer and title upon issuance:
- Not to encumber the master title without the FI's consent.
 - To obtain the relevant consent to transfer in due course.

- (c) From chargee (where title is not available and developer has charged the master title to another FI – chargee)
- To exclude the property in the event of foreclosure.
 - To forward the discharge of charge upon issuance.
 - To refund the redemption sum in the event of non-registration of the discharge of charge.
- (d) From chargee or assignee
- To forward the discharge of charge, duplicate charge and title or receipt and assignment.
 - To refund the redemption sum in the event of non registration of the discharge of charge or receipt and reassignment.
- (e) From vendor (duly attested) to refund the whole loan sum in the event of non-registration of transfer.
- (f) For sub-sale (without title)
Developer’s confirmation that there are no fees and charges outstanding.

(b) Fixed Deposits

Memorandum of deposit of fixed deposit

- Letter of set-off (This document is to be stamped for a nominal sum if these documents are not principal documents).
- Original Fixed Deposit Receipt issued by the FI to be in possession of the FI.

(c) Shares

Memorandum of deposit of shares

- CDS account of the borrower to be opened in the FI’s nominee’s name.
- Letter of IPO/ Bumiputra or special allotment, if applicable.

(d) Unit trusts (for ASB/ASN unit trusts only)**Memorandum of deposit of unit trusts**

- The document is to be stamped for a nominal sum.
- The account of the unit trust holder to be endorsed in favour of the FI's nominee's name.
- Resale agreement to be signed by the unit trust holder.

(e) Support documents**(i) Letter of Guarantee**

- The document is to be stamped for a nominal sum.
- Original letter of guarantee executed by guarantor and duly witnessed by the bank staff /solicitors/commissioner of oaths.
- Compliance to BNM guidelines:
Pre-signing requirements as per BNM guidelines (effective October 10, 1995) for guarantees not exceeding RM250,000. This requirement does not apply to facilities granted to corporate bodies and individuals where the spouse is the guarantor.
 - The lender shall not request for more than two guarantors.
 - The borrower to disclose in writing to the guarantor all credit facilities already granted to the borrower by all financial institutions and all guarantees given by the applicant personally for which the applicant is directly and personally liable. The lender is to ensure that it receives a copy of the disclosure letter from the applicant.
 - Require the borrower to provide the lender with a letter giving the lender permission to disclose to the guarantor all correspondence between the lender and the borrower.
 - Inform the guarantor in writing of his rights and liabilities to the lender in respect of the credit facility applied for by the applicant.
 - Require the guarantor to confirm in writing that he has received the disclosure letter and his willingness to act as a guarantor. Upon receipt of the confirmation letter from the guarantor, the

lender shall give the guarantor a consideration of five working days (from date of receipt of letter) to consider his decision before the lender can require the guarantor to execute the contract of guarantee.

Post-signing requirements

- The lender shall not grant any further credit facility other than a credit facility not exceeding RM5,000 to the borrower without prior consent of the guarantor
- The lender shall send to the guarantor a copy of the statements of the borrower's account (at least twice a year), reminders of late payment and letter of demand.

(ii) Life policies

- Absolute assignment of life policy.
- The document is to be stamped.
- Acknowledgement of the assurance company of the assignment.

(iii) General / fire insurance policies

- The FI's mortgagee to be noted of the insurance policy.
- Conditions attached to the policy are to be examined.

(iv) Land search

- Evidence that a search has been conducted on the land charged to the bank and that the land is free of encumbrances.
- Consent to transfer/charge has been obtained from the relevant authorities where applicable.

(v) Bankruptcy search

Evidence that a bankruptcy search on the borrower has been conducted and the official assignee's reply.

Some FIs request for a statutory declaration that the borrower is not a bankrupt. This is in view of the delay in making the search. In the event the search reveals the borrower as a bankrupt, it becomes an event of default and the loan is recalled.

2.2 Compliance with terms and conditions

As in all lending, the lender needs to mitigate his risks of default over the life of the lending relationship. As such, he needs to stipulate covenants or legal agreement in:

- (a) Letters of offer;
- (b) Security documents; and
- (c) Other loan documents.

2.3 Objectives of the lender

To ensure timely repayment.

Example: The borrower to open an account where a monthly deduction will be made to the credit of his loan account.

2.4 Magnitude of credit risks

The more vulnerable a loan the stronger should be the tone of the covenant.

Example: The bank may insist on the borrower's salary be credited to his account with the bank.

2.5 Scope of the covenants

The higher the risk of the loan the more extensive will be the covenants. The lender must be able to anticipate any potential problems that may arise. In order to do that, he needs triggers to signal any warning signs.

Example: The lender may require the borrower to inform the lender of change of employment or submit the Form J annually.

2.6 Types of covenants

2.6.1 Conditions precedent

These are covenants that need to be complied prior to the disbursement of the loan. For example:

- (a) Letter of confirmation of employment.
- (b) Consent of the Menteri Besar for transfer of the property.
- (c) Original receipt evidencing payment of 10% deposit to the developer.
- (d) Legal opinion of the solicitors confirming that the collateral charged to the bank is free from encumbrances.

2.6.2 Positive covenants

As the terms suggests the lender, will require some actions or events that the borrower must cause to occur in the future. For example:

- (a) The borrower to take out motorcar insurance every year.
- (b) To pay the quit rent before the 31st May every year.

2.6.3 Negative covenants

These are terms the lender will require some actions or events that the borrower must **not** cause to occur in the future. For example: Not to rent out the house taken under housing loan as the low interest housing loan is meant for a owner-occupied house

2.6.4 Events of default

These covenants act as triggers to recall the loan. For example:

- (a) Failure to pay principal and interest when due.
- (b) Failure to perform other covenants and conditions in the loan agreement.

2.6.5 Financial covenants

Financial covenants are covenants expressed in financial terms. For example: The borrower to maintain a minimum balance of RM100,000 in his current account.

2.6.6 Other Conditions

From developer or vendor's solicitors that the difference between loan price and purchase price has been settled.

2.7 Risks and control

2.7.1 Charge documents

Even though the charge can be perfected, the bank will be at risk if the transfer is rejected. It will also mean that the charge will eventually be rejected. As such, the memorandum of transfer should be duly registered

2.7.2 Valuation report

A copy of the valuation report from an approved panel of valuers addressed to the lender for purpose of the loan is to be obtained.

2.7.3 Fire insurance

Fire insurance is taken for 60 to 70% of the market value of the property as it does not include the value of the land. Prior to the completion of the building, the onus of insurance lies with the developer.

2.7.4 Developer's license

A developer's license is required for construction of more than 4 houses. The developer is also required to have an advertising permit as required by the Ministry of Housing and Local Government. A copy of the license and advertising permit is to be obtained.

2.7.5 Quit rent

The borrower is required to pay all quit rent and assessments on their due dates. If the borrower fails to pay, the land may be taken back by the land office. Even the FI as chargee will lose its interest on the land. Therefore, it would be prudent for the lender to pay the quit rent in the event of failure by the borrower to pay and then claim it from the borrower.

2.7.6 Architect's certificate

The qualification of the architect to give a certificate must be verified. There are various categories of architects. Some are qualified to give certificates for less than four units only.

2.7.7 Site visits

Despite the architect's certificate being forwarded, errors to the certification can occur. E.g. a certificate meant for lot No. 3 is given for lot No. 5. To verify the architect's certificate, a site inspection needs to be conducted. Photographs should be taken and kept as a record for further verification by the borrower.

2.7.8 House whether built on the correct piece of land

Prior to construction, a piece of property may just be part of a large tract of vacant land. A house can be constructed on a different plot of land to the one the FI has financed and is holding a charge on.

When in doubt, a surveyor's report can be called for.

3. Post-Disbursement

Once the funds have been disbursed, it becomes the duty of the credit administration officer to ensure that the funds are used for the purpose they were intended for. Though total control cannot be enforced in this area, the opportunity to misuse the funds by the borrower or the developer can be reduced.

Currently, there are stringent requirements for the utilisation of funds meant for housing by housing developers as required by the Housing Developer's Act.

3.1 Notification of disbursement

It is important to notify the borrower of the disbursement, as interest on the loan will commence immediately for which the borrower has to make payment.

Death of the borrower at the time of disbursement for a progressive loan release will not in any way prevent the lender from disbursing the funds. This is due to the contractual obligation of the lender with the developer wherein the lender would have undertaken to pay against the architect's certificate for progressive completion.

The lender should also educate the customer on the following:

- How to effect payment when payment is due;
- How are late charges calculated;
- The importance of making payment on time to preserve a good rating;
- Methods of calculating interest;
- How extra payments are handled, e.g. advance payments go towards payment of instalments and pre-payments towards principal payments;
- How excesses in the account (overdraft) are handled; and
- Who to contact when faced with a problem.

If a borrower understands the above, he or she will most likely comply with the terms of the loan. In short, 'a well made loan is half collected'.

3.2 Notify changes in interest rates and repayment whether shortened or extended

As most loans are pegged to the Base Lending Rate (BLR) of the FI, it becomes the duty of the credit administration officer to inform the borrower of changes as soon as possible whether the change is in favour of the borrower or not. In tandem with that, any change in the instalment

also needs to be communicated. Normally, computer-generated letters inform of changes in interest rates globally.

3.3 Types of covenants

Misuse of funds can lead to losses to the borrower and thereafter non-payment of the loan. Other factors can also lead to the eventual non-payment of the loan. As such, to alert the FI, triggers are set in place. These can be in the form of covenants. Violation or breach of the covenants can result in the loan being recalled.

3.3.1 Events of defaults

- (i) Failure to notify the lender of bankruptcy.
- (ii) Breach of maintenance of margin (for shares and unit trusts).
- (iii) Ceased employment (if it is in the terms of the letter of offer).
- (iv) Breach of section 62 of BAFIA.
- (v) Death or mental incapacity.

3.3.2 Positive covenants

- The borrower to pay all quit rent and assessments on due dates.
- Renew insurance policies.

3.3.3 Negative covenants

Loan proceeds cannot be used for purposes other than that intended for in the approval of the loan.

3.4 Loan administration (annual review and renewal)

Except for term loans, most credit facilities are granted on a yearly basis and reviewed for renewal. This again provides an opportunity for the credit administration officer to review the documentation.

The loan review function for documentation includes:

- Ensuring that the loan is in compliance with all applicable regulations;
- Examining completed documents for accuracy, completeness and adherence to the FI's lending policy;
- Security coverage is adequate especially for shares;
- Utilisation of facility;
- Repayment track record;

- Following up to resolve documentation errors. (Errors are sometimes detected after the loan is disbursed. This can happen when funds are disbursed against undertakings to deliver the documents);
- Developing and maintaining management information about items such as documentation problems and the lender's performance; and
- Maintaining follow-up for the necessary insurance documents.

4. Summary

Loan disbursement is an important element in developing a sound consumer portfolio.

It involves preparing and executing loan documents that comply with all applicable regulations and provides the FI with a firm basis for collecting and recalling its loans.

The documents must be accurate and complete in order to establish the FI's and the consumer's rights under the terms of the loan arrangement. When a loan is to be secured by collateral, the FI must attach and perfect a security interest in the collateral. This requires a clear understanding of the regulations and state laws.

The loan review function helps ensure that the loan is in compliance with all applicable regulations and that documentation is accurate and complete. Loan review is also responsible for following up on documentation necessary to secure collateral and for providing reports to management.

Practice Questions

1. What happens when a bank does not perfect its documentation?
2. What would you look out for in the completed security documentation for a housing loan where the property has been issued with a title deed?
3. What are the possible documents to be taken for shares?
4. What are the BNM guidelines for pre- and post-signing of a letter of guarantee?
5. What are the possible risks and controls when taking documentation?
6. What are the different types of covenants and why are covenants important?
7. Name some events of default.
8. What is the purpose of the loan review function and how does it benefit the bank?