

DP03

Principles of Lending

11 APRIL 2007

1. Time allowed : Three (3) hours
2. Total number of questions : Four (4) questions
3. Number of questions to be answered : All four (4) questions
4. Show details of workings where appropriate. Silent, non-programmable calculators may be used.
5. Begin each answer to a new question on a fresh page.
6. Answer **all** questions in **English**.
7. Blank pages are provided at the end of the question paper for rough work.

ANSWER ALL FOUR (4) QUESTIONS

1. (a) List and explain the guidelines on principles of good lending. [15]
(b) Briefly explain the importance of legal documentation for the borrower, lender and third party (if any) in a credit process. [10]
(Total:25 marks)
2. Mr A is in the furniture manufacturing business. Mr A sources raw materials from overseas as well as from local timber mills. The finished products are bedroom furniture sets, complete outdoor garden furniture and dining sets. All finished products are exported to Europe and America.
Mr A has requested from you to:
(a) introduce to him **five** types of trade financing facilities suitable for his business. [5]
(b) provide the functions and indicative pricing of the five types of trade financing facilities identified in (a) above. [20]
(Total:25 marks)
3. (a) Briefly describe **five** functions of credit administration. [15]
(b) Discuss the justification for annual credit review of borrowers. [10]
(Total:25 marks)
4. The overall objective of bank lending is to finance viable businesses irrespective of size to achieve sustainable and superior returns to shareholders. Credit managers, therefore, need to evaluate revenue opportunities weighed against probability of losses from loan defaults. They also need to strike a balance between lending against assets/collateral versus cashflow.
Explain how the concept of 5Cs of credit can assist credit managers in their bank lending decision process. (Total:25 marks)

– END OF QUESTION PAPER –

OUTLINE ANSWERS

The comments given in the boxes below indicate the areas of weaknesses the examiners have identified and their advice to future candidates.

Question 1

- Candidates strength was on the guidelines on principles of good lending.
 - Candidates were unable to state the legal relationship and obligation of the borrower in a credit process.
1. (a) Refer to page 55, unit 4.5 of the Bank Lending, Assessment and Management textbook by Howard Choo.
- (b)
- Ensures there is a binding contract between borrower, lender and/or third party
 - Captures the terms and conditions in the transaction
 - Includes perfecting collateral (i.e.: charge under National Land Code 1965)
 - Binds the guarantors by way of personal Guarantee or Corporate Guarantee in the case of a company
 - Provides a security memorandum in the case of pledge of shares and fixed deposits
 - Avoids allegations of frauds, duress or undue influence in the credit process

Question 2

Candidates had good knowledge on loan products.

2.

(a) Types of trade financing facilities	(b) Functions	(b) Indicative pricing
Letters of Credit (LC)	For importation of capital goods. Payment upon evidence of goods loaded on ship in the case of sight LCs, or payment on credit terms if seller allows a credit period (i.e.: usance LCs).	0.1% to 2.5% per month
Trust Receipts (TR)	To finance payment of capital goods where sellers are not providing credit terms. Banker pays on the sight LC document and converts the loan into a TR of between 30-120 days.	1% per annum to 2% per annum above BLR
Shipping Guarantee (SG)	In the case of imports, where goods have arrived but documents are still in transit. Bank issues a SG to allow goods to be cleared from the port pending arrival of import documentation.	1% per annum to 2.5% per annum
Bankers Acceptance (BA)	BA can be used to finance either cash purchases or credit sales. The period can range between 30 days to 120 days depending on the asset conversion cycle and the lenders' comfort level.	Floating rate of 1% per annum above the BA discount rate
Export Credit Refinancing (ECR)	Both pre and post-shipment can be used to assist an exporter. Pre-shipment financing available when confirmed orders are received to fund raw materials purchase and post-shipment financing to finance credit sales.	BNM rates adjusted from time to time

Question 3

Candidates were confused between credit evaluation functions and credit administration functions.

3. (a) Functions (*Give any **three** of the following*)
- To provide an effective risk management of a bank's assets and administration of sound credit policy
 - To manage a centralised customer database.
 - To perform loan documentation and provide activation of credit facility after ensuring that the loan documentation and other precedents are complied.
 - To ensure valuation of collaterals are carried out on a regular basis.
 - To send out reminders for credit renewals or renewal of collaterals.
 - To cancel limits of customers when facility is settled.
 - To release any collaterals held upon an account been fully settled and cancelled.
- (b)
- To evaluate continuing business viability
 - To evaluate collateral value and exposure coverage
 - To review financial performance
 - To review loan covenants and material credit terms compliance
 - To review risks position of the bank and update risk ratings

Question 4

Candidates had good knowledge of the 5Cs of credit.

3. Refer to page 86, unit 6.3 of the "Bank Lending – Assessment and Management" textbook by Howard Choo.