Chapter 5

Models for Evaluating The Creditworthiness of banking institution

First: The nature of credit risks as a basis for assessing creditworthiness.

1-The concept of credit risk: The losses expected to occur when the customer (borrower) stops paying his obligations according to the terms agreed upon with the bank or the losses resulting from the bank's failure to determine and assess the creditworthiness of customers when granting them credit or the losses resulting from granting credit to a specific group of customers or geographical areas without sufficient guarantees

First: The nature of credit risks as a basis for assessing creditworthiness.

2-Factors affecting credit risks for customers:

A - External factors:

- Continuous changes in the economic environment such as the economy heading towards recession or depression or an unexpected collapse in the financial markets.

First: The nature of credit risks as a basis for assessing creditworthiness.

- **Rapid technological progress, which has led to the removal of spatial boundaries between markets and financial institutions and their rapid growth and diversification, which has led to an increase in the intensity of competition between global commercial institutions and banks.**

First: The nature of credit risks as a basis for assessing creditworthiness.

- Changes in market movement that have negative effects on the counterparty and related parties.
- Political changes and trends that have a negative financial and/or administrative impact on the customer's industry or activity.

First: The nature of credit risks as a basis for assessing creditworthiness.

B - Internal factors of credit risks:

- Weakness of credit or investment management in the bank, whether due to lack of experience or insufficient training.
- Lack of a sound credit policy followed by the bank's credit officers.

First: The nature of credit risks as a basis for assessing creditworthiness.

- **Weak pricing and estimation policies for financial instruments.**
- **Weak credit risk monitoring procedures and control policies.**
- **Weak diversification of credit portfolios and credit concentrations, whether for individuals, sectors or geographical areas.**

First: The nature of credit risks as a basis for assessing creditworthiness.

3-Credit risk measurement indicators that commercial banks rely on:

3/1-The ratio of loans that have been due for 90 days or more to the total loans granted to customers.

3/2-Ratio of net debt exclusions - with the approval of the responsible authority - to the total loans.

First: The nature of credit risks as a basis for assessing creditworthiness.

3/3-The ratio of the annual provision for loans to the total loans or to the total share capital.

3/4-The ratio of losses allowed to the total loans or to the total share capital.

Second: The nature and importance of assessing customers’ Creditworthiness.

1-The concept of customer creditworthiness: a set of decision-making models and techniques that help lenders grant loans to customers. These techniques determine the beneficiaries of credit, the size of credit, financing strategies, and mechanisms for maximizing the benefit of banks and financing institutions by assessing the risks of each consumer individually.

Second: The nature and importance of assessing customers' Creditworthiness.

2-Advantages of credit assessment:

- Reducing operating costs to achieve better and sufficient growth to meet low profit margins and additional costs.
- Supporting the high operational capacity that banks suffer from.
- Reducing defaults.
- Increasing growth rat

Second: The nature and importance of assessing customers' Creditworthiness.

2-Advantages of credit assessment:

- Increasing the size of loans.
- Activating, studying and analyzing financing relationships periodically.
- Developing the quality of decision-making, and providing more time for expert analysts to review emergency cases (fraud cases).

Second: The nature and importance of assessing customers' Creditworthiness.

3-Principles of credit assessment: The main principle of credit assessment is its ability to predict the future financial performance of the customer based on analytical methodologies for the customer's historical credit behaviors and linking them to known relationships that together determine whether this customer will fulfill his future obligations on time or not.

Second: The nature and importance of assessing customers' Creditworthiness.

4-Challenges facing credit assessment: **Credit assessment faces four main challenges in Arab countries, in addition to the lack of systems and legislation in all Arab financing markets, especially in Egypt. These challenges can be summarized as: data volume, data diversity, data accuracy, and finally data exchange.**

Second: The nature and importance of assessing customers' Creditworthiness.

5-Factors and determinants of creditworthiness assessment:

The Central Bank of Egypt report in 2016 stressed the need to take into account the following factors to determine the creditworthiness of institutions:

- **Analysis of the institution's management and a statement of technical cadres and their expertise, management strategy and policies for achieving them.**

Second: The nature and importance of assessing customers' Creditworthiness.

- **A detailed analysis of the industry and/or market, the most important competitors and the institution's market share.**
- **Results of the analysis of the client's financial position as reflected in its financial statements for at least the last three years.**
- **Results of recent inquiries about the client and its transactions with other banks and the results of field visits.**

Second: The nature and importance of assessing customers' Creditworthiness.

- The status of the client's obligations before sovereign entities such as the Tax Authority and the National Insurance Authority.
- A consolidated statement for the client and related parties clarifying..
- Analysis of the client's transactions with the bank and the extent of commitment or violation of the terms of credit

Activity No. (1)

- **Activity nature:** Discussion.
- **Activity Time:** 5 minutes.
- **Task:** Discuss The Advantages of credit assessment

5 minute break.....

Tea Break

Third: Practical procedures for granting bank credit to customers.

The most important of these stages are as follows:

1-The client submits a request to obtain credit facilities, specifying in the request the types of these facilities, their amounts, their purpose, how and when to repay them, and the guarantees that can be provided.

Third: Practical procedures for granting bank credit to customers.

2-Organizing a personal interview and setting a field visit for the applicant, with the aim of getting to know his personality and experience in the field of activity, the nature of this activity, the location of the project, machinery and equipment, the steps of the production process, the degree of technology used, storage systems, sales methods….

Third: Practical procedures for granting bank credit to customers.

3-Inquiring about the client in terms of his reputation, transactions, and the extent to which he fulfills his obligations with suppliers, clients, and the banks he deals with, and whether legal measures have been taken against him or not. The inquiry stage is one of the most important stages of making a credit decision…

Third: Practical procedures for granting bank credit to customers.

4-Initial "preliminary" examination of the application, a set of documents are verified, some of which are financial, such as the budget and final accounts for the previous three years, a certificate of tax status, and some of which are non-financial, such as the commercial register, the exporters' register, the company contract, the tax card, and previous work. It must be emphasized.

Presentation activity……..

- **Activity nature:** **Presentation.**
- **Activity Time:** **10: 12 minutes.**
- **Skills:** **Professional financial analysis**

The Next Lecture

Con..Chapter 5

Models for evaluating the creditworthiness

of banking institutions