Con.. Chapter 5

Models for Evaluating

The Creditworthiness

of banking institution

Fourth: Models for judging the creditworthiness of customers and indicators for measuring them.

Credit analysts and grantors worldwide rely on judging the creditworthiness of customers to grant loans and credit facilities by studying several basic aspects whose number of variables increases from time to time and from one country to another. These models can be presented in detail with an indication of their development as follows:

1-The Three C'S Credit Characteristics Model: The Three C'S Credit Characteristics Model is one of the oldest models used to assess the creditworthiness of customers. This model is based on the need to study and analyze three main characteristics of the customer to know the customer's worthiness of financing. **These characteristics are represented in each of:**

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❑ **Personal Characteristics**

❑ **Capital**

❑ **Ability to repay Capacity**

8-The 18 C'S Credit Characteristics Model: This model focused on combining the factors addressed by previous evaluation models and extracting eighteen criteria to evaluate the creditworthiness of customers from all aspects. These criteria are:

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❑ **Personal characteristics / culture:** This criterion includes evaluating the safety of the borrower himself or the industry sector in which he operates, and the associated risk rates.

❑ **Competence:** It includes studying the ability to introduce a specific new product and achieve profits at satisfactory rates.

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❑ **Continuity of Management:** refers to the availability of sufficient guarantees to protect against the loss of key individuals in the financing entity.

❑ **Corporate Constitution:** refers to the extent of the existence of a clear structure for the company and specific controls.

❑ **Consumer / Competition:** Embodies market estimates and prevailing conditions.

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❑ **Controls over Costs and Cash:** refers to the main items related to the lack of sales growth or decline.

❑ **Capacity to Contract:** where there must be sufficient diversification of the business to confront its failure cases.

❑ **Creditability of Accounts:** There must be reliability in the audited accounts (that have been reviewed), provided that they are clear and easy to interpret.

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❑ **Cause or Purpose & Term of Loan:** Studying the risks associated with granting the loan and its realism.

❑ **Capital Required:** It is concerned with the availability of total capital to meet costs.

❑ **Capital Contribution of The Bank:** It includes the available funds that will be subject to the banks' obligations towards the various sectors

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❑ **Contribution to Bank Profits:** It indicates the importance of linking the bank's interest rate estimates to the risk rates associated with borrowers.

❑ **Commitment:** It is concerned with stating the extent of the availability of the commitment of borrowers to estimate and evaluate the possibilities of repayment.

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❑ **Contingencies:** Where the repayment schedules should include all normal and emergency possibilities of repayment obligations.

❑ **Comprehensive Cash Flow Projections:** It indicates the importance of estimating cash flows in light of studying and analyzing risks and determining the extent of the borrower's ability to repay the total loans.

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❑ **Current Trading:** This criterion requires studying the management's ability to draw up plans and policies to activate and supervise the components of current trading.

❑ **Condition of Drawdown:** This criterion focuses on ensuring that the guarantees are complete before the borrower withdraws the loan value or activates the credit facility.

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❑ **Continuing Covenants:** Indicates that borrowers will need to demonstrate their ability to fulfill their covenants towards certain determinants such as: profitability and liquidity on an ongoing basis.

Activity No. (1)

- **Activity nature:** Discussion.

- **Activity Time:** 5 minutes.

- **Task:** Discuss The Important C'S Credit Characteristics Model

5 minute break.....

Tea Break

Fifth: The nature and advantages of investment funds

1- Digital Credit Score Table:

Digital Credit Rating of Mr......			
Main indicator	**Sub-indicators**	**maximum degree**	**Estimated grade**
First: Evaluation of financial factors:			
Industry Stability	Stability of demand and supply.	10	
	Degree of dependence on other industries.	7	
	Availability of high export capabilities.	8	
	Total	25	

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Institutional Stability	Sales growth rate.	15	
	Total assets growth rate.	15	
	Equity growth rate.	15	
	Net income growth rate.	15	
	Total	**60**	
Competitiveness	Pricing and costing system.	5	
	Total	**5**	
Operational Performance Indicators and Results	Return on sales.	15	
	Gross profit to sales.	15	
	Return on equity.	15	
	Return on total assets.	15	
	Total	**60**	

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Cash Flows	Net cash flows from operating and investing activities.	20	
	Net cash flows from operating and investing activities / Financing interest and installments during the year for term loans.	20	
	Total	40	
Net Financial Position	Net profit to gross profit.	10	
	Net profit to financing charges.	10	
	Total	20	

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Financing and Facilities Structure	Debt to equity ratio.	12,5	
	Financial leverage.	12,5	
	Current ratio.	12,5	
	Quick payment ratio.	12,5	
	Total	50	
▪ Overall financial indicators evaluation.		260	

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Second: Evaluation of non-financial factors:			
Competitiveness of the organization	The company's market share.	15	
	The company's impact on local and international competition.	10	
	The diversity and multiplicity of products and services.	5	
	The company's ability to market existing or new products or services.	5	
	The company's ability to develop its products.	5	
	Total	**40**	
Financial Position	Regularity.	15	
	Payment of obligations.	15	
	The ability of major shareholders to provide additional funds.	10	
	Total	**40**	

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Internal Management and Control	Experience of senior management levels.	10	
	Management ability to prepare and implement plans.	10	
	Internal control systems and reports.	10	
	Total	30	
Dealing with Legal Issues	The impact of legal problems on the institution or its departments.	10	
	The extent of problems with sovereign entities.	10	
	Total	20	

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Financing Structure and Facilities	Ability to access local or international capital markets.	10	
	Risks associated with the term of the facility.	10	
	Risks of the currency of the loan.	10	
	Commitment to fulfilling documents and conditions.	10	
	Profitability of transactions.	10	
	Inquiry results.	10	
	Visit results.	10	
	Guarantees.	20	
	Suitability of facilities.	10	
	Total	**100**	

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Outstanding Balances	Outstanding balances.	10	
▪ Total non-financial indicators rating.		240	
▪ Total overall customer worthiness rating.		500	
▪ Percentage of numerical rating.		%100	

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2-Standard classification categories creditworthiness:

NO	Category	Classification level	percentage
1	Low Risk	Highly Distinguished	More than 95% : 100%
2	Moderate Risk	Excellent	More than 90% : 95%
3	Satisfactory Risk	Very Good	More than 80% : 90%
4	Adequate Risk	Good	More than 70% : 80%
5	Acceptable Risk	Acceptable	More than 60% : 70%
6	Moderately Acceptable Risk	Under Monitoring	More than 50% : 60%
7	Risk Requires Care	High Risk	More than 45% : 50%
8	Substandard	Substandard	Less than 45%
9	Doubtful	Questionable	
10	Poor	Poor	

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3-Determinants of customer classification considering the result of the digital creditworthiness assessment:

Customer Rating / ………………………………… in light of the digital evaluation result				
Evaluation Officer/Authority	percentage	Level	Category	Classification
Mr/………	% …..	…….	…….	…….

4-Credit decision: The credit decision is most often taken collectively through the committees specialized in each sub-unit, or through presentation to representatives of the regional areas, or through presentation to the committees specialized in the main centers and the membership of the Board of Directors, according to the nature and size of the loans and credit facilities.

Case study activity... Example page 177

- **Activity nature:** Case study.
- **Activity Time:** 30 minutes.
- **Skills:** creditworthiness assessment

The Next Lecture

Chapter 6

Liquidity as a basis for financial failure

Risk in financial institutions

GOOD BYE