



BM4220

Consumer Banking Management

Topic 4: Credit Analysis



Agenda

Topic 3 will cover:

Definition of Credit Analysis & Credit Policy

Objectives of Credit Policy

5Cs of Good lending

Credit evaluation and the risk trade-off

Alternative data for credit scoring

Definition of Credit Analysis & Credit Policy



Introduction to Credit Analysis



Definition: Credit analysis is the systematic evaluation process used by banks to determine the creditworthiness and repayment capability of potential borrowers.

Purpose: Ensures banks make informed lending decisions, reducing risk and enhancing profitability.

Significance of Credit Analysis in Consumer Banking



Essential for risk management to prevent defaults and financial losses.



Protects bank's assets by identifying reliable borrowers.



Enhances the quality of the loan portfolio, ensuring sustainable business growth.



Ensures compliance with regulatory requirements (e.g., MAS guidelines).

Role in Risk Mitigation



Identifies potential credit risks through comprehensive assessments.



Assesses borrowers' financial stability and repayment capacity.



Establishes appropriate credit limits and loan terms.

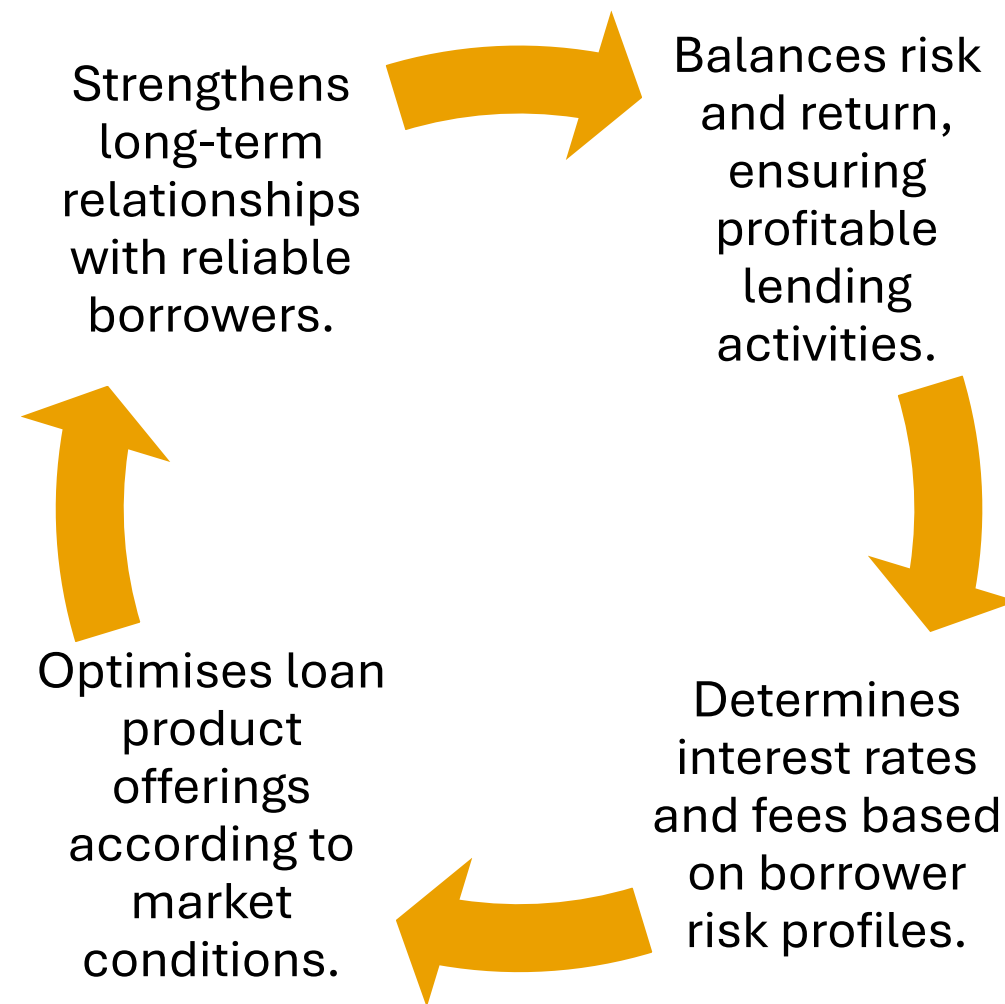


Implements preventive measures to reduce Non-Performing Loans (NPLs).



This Photo by Unknown Author is licensed under CC BY-SA-NC

Enhancing Profitability through Credit Analysis



Overview of Common Consumer Credit Products



Personal Loans: Unsecured loans for personal use such as education, medical expenses, or emergencies.



Housing Loans: Loans secured by property, including loans for purchasing HDB flats and private condominiums.



Auto Loans: Loans specifically tailored for the purchase of motor vehicles.



SME Loans: Financing options for small and medium enterprises, including working capital loans, trade finance, and asset financing.

Objectives of Credit Policy

A blue pen with a silver tip is resting on a document. The document features a bar chart with several blue bars of varying heights. The background is a light blue and white grid.

Definition of Credit Policy



A credit policy comprises detailed guidelines established by a financial institution to evaluate loan applications effectively. It serves as a structured framework for assessing borrower risk, determining creditworthiness, and making consistent lending decisions aligned with regulatory compliance.

Objectives of Credit Policy

- **Profitable Loan Portfolios:** Ensures loans issued generate positive financial returns and meet profitability targets.
- **Minimising Non-Performing Loans (NPL):** Reduces risks by screening borrowers and ensuring timely repayments.
- **Consistency and Fairness:** Standardised evaluation criteria to maintain fairness in loan approvals.
- **Flexibility:** Enables quick adaptation to changes in market conditions or regulatory guidelines.

Ensuring Profitable Loan Portfolios

Targeting optimal risk-return balance.

Strategic allocation of loans based on profitability criteria.

Regular review of loan portfolio performance and adjustments when needed.

Example: Interest rates adjustment based on borrower's risk profile.

Minimising Non- Performing Loans (NPL)



Importance of detailed due diligence.



Monitoring borrower repayment behaviours regularly.



Proactive management of potentially problematic loans.



Example: DBS uses predictive analytics to monitor and manage NPL risks.

Consistency and Fairness in Decision- Making

Developing clear guidelines that minimise subjective judgements.

Implementing structured evaluation protocols.

Training credit analysts consistently to adhere strictly to policy.

Example: Standard Chartered Singapore's structured loan evaluation processes ensuring fairness across loan approvals.

Flexibility and Responsiveness to Change

- Need for policies to reflect economic trends and regulatory shifts.
- Regular reviews of credit policies for relevance.
- Prompt adjustments following MAS regulatory announcements.

Example: Banks in Singapore quickly adapting credit policies after MAS updates such as changes to Total Debt Servicing Ratio (TDSR).

MAS Notice 632: Residential Property Loans

MAS Notice 632 is a key regulatory instrument that sets out the rules and guidelines for banks in Singapore when granting residential property loans. Here's a breakdown of its significance:

Purpose:

- It aims to ensure prudent lending practices by financial institutions in the residential property market.
- It plays a vital role in maintaining financial stability and preventing excessive leverage in the property sector.
- It provides clarity on the limits and conditions for residential property loans.

Key Aspects:

- **Loan-to-Value (LTV) Limits:** The notice specifies the maximum LTV ratios that banks can offer, which vary depending on factors such as the number of outstanding housing loans a borrower has.
- **Regulations on Credit Facilities:** The notice regulates the granting of credit facilities for the purchase of residential properties, by individuals and non individuals.
- **Checks and Declarations:** It mandates that banks conduct thorough credit checks and obtain declarations from borrowers regarding their financial situation and property ownership.
- **Refinancing:** The notice also includes rules pertaining to the refinancing of residential property loans.

Impact:

- MAS Notice 632 directly influences the lending policies of banks in Singapore, including OCBC, UOB, and DBS.
- It contributes to the overall stability of the property market by controlling the amount of credit available for property purchases.
- It gives a framework for the banks to operate within, when loaning out money for property.

Where to find it:

- The official MAS website is the best place to find the most current versions of MAS Notice 632. You can access it through the MAS regulations section.

5Cs of Good lending



Overview of the 5 Cs of Credit



Character: Integrity and trustworthiness



Capital: Borrower's financial stake in loan



Capacity: Ability to repay loan



Condition: Purpose, amount, tenure, and economic environment



Collateral: Assets pledged as security

Definition of Character



Refers to borrower's integrity, honesty, and reliability.



Crucial for determining borrower's willingness to repay.

Methods to Evaluate Character

Credit Bureau Reports: Credit history, repayment behaviours, and outstanding liabilities.

Employment Stability: Consistency and duration of employment.

Legal and Regulatory Checks: Bankruptcies, lawsuits, compliance with regulations.

Definition of Capital



FINANCIAL CONTRIBUTION OR
ASSETS BORROWERS PROVIDE
TOWARDS THE LOAN.



DEMONSTRATES BORROWER'S
COMMITMENT TO LOAN
REPAYMENT.

Importance of Capital



Indicates borrower's financial commitment ("skin in the game").



Reduces risk for banks by ensuring borrower's stake in loan repayment.

Evaluating Capital

Calculation of borrower's net worth (Total Assets - Total Liabilities).

Assessment based on real estate holdings, savings, investments.

MAS Regulatory Guidelines (MAS 635)

This MAS notice is crucial for understanding how financial institutions in Singapore manage unsecured credit.

MAS Notice 635 sets out the regulatory requirements for banks in Singapore when granting unsecured credit facilities to individuals.

- It aims to promote responsible lending practices and prevent excessive indebtedness among individuals.
- In essence, it is a tool to maintain financial stability.

•Key Areas Covered:

- **Eligibility Criteria:** The notice includes guidelines on the minimum income requirements for individuals to qualify for unsecured credit.
- **Credit Limits:** It addresses regulations related to credit limit management and the granting of unsecured credit facilities.
- **Credit Assessments:** The notice emphasizes the importance of thorough credit assessments by financial institutions.
- **Debt Consolidation:** The notice also addresses the rules surrounding debt consolidation.

•Impact on Financial Institutions:

- Banks operating in Singapore must adhere to the requirements outlined in MAS Notice 635.
- This influences their internal policies and procedures for granting unsecured credit.
- It helps to provide a framework for the banks to operate within, when loaning unsecured credit.

•Where to find the information:

- The most reliable source for MAS Notice 635 is the official MAS website.

Case Study: Assessing Mr. Tan's Net Worth for Loan Application

Mr. Tan, a resident of Singapore, is applying for a substantial loan to expand his business. To assess his creditworthiness, the bank needs to evaluate his net worth, considering his various assets.

Asset Breakdown:

1.Real Estate Holdings:

1. Mr. Tan owns a condominium apartment in a prime district of Singapore, valued at S\$2.5 million. There is an outstanding mortgage of S\$800,000.
2. He also owns a commercial shophouse, valued at S\$1.8 million, with no outstanding loans.
3. This means he has S\$1.7 million of equity in his condominium, and the full 1.8 million of the shophouse.

2.Vehicles:

1. Mr. Tan owns a luxury car, valued at S\$200,000. There is an outstanding car loan of S\$50,000.
2. He also has a commercial van used for his business, valued at S\$80,000, with no outstanding loans.
3. This provides 150,000 equity on the luxury vehicle.

3.Personal Savings:

1. Mr. Tan has S\$300,000 in savings accounts and fixed deposits.
2. He also has 150,000 in various stock market holdings.

4.Other Personal Assets:

1. Mr. Tan owns a collection of valuable art pieces, estimated at S\$100,000.
2. He also has ownership in a private business, which is estimated to be worth 500,000.

Case Study: Assessing Mr. Tan's Net Worth for Loan Application

Net Worth Calculation:

Real Estate: $(S\$2,500,000 - S\$800,000) + S\$1,800,000 = S\$3,500,000$

Vehicles: $(S\$200,000 - S\$50,000) + S\$80,000 = S\$230,000$

Personal Savings: $S\$300,000 + S\$150,000 = S\$450,000$

Other personal assets: $\$100,000 + \$500,000 = \$600,000$.

Total Net Worth: $S\$3,500,000 + S\$230,000 + S\$450,000 + \$600,000 = \underline{\underline{\mathbf{S\$4,780,000}}}$

Analysis:

Mr. Tan has a substantial net worth, primarily driven by his real estate holdings.

His savings and other assets further strengthen his financial position.

However, the bank will also consider:

- The liquidity of his assets (how easily they can be converted to cash).
- The stability of his income.
- The performance of his business.
- Fluctuations in the real estate market.
- Risk assessment of his business.

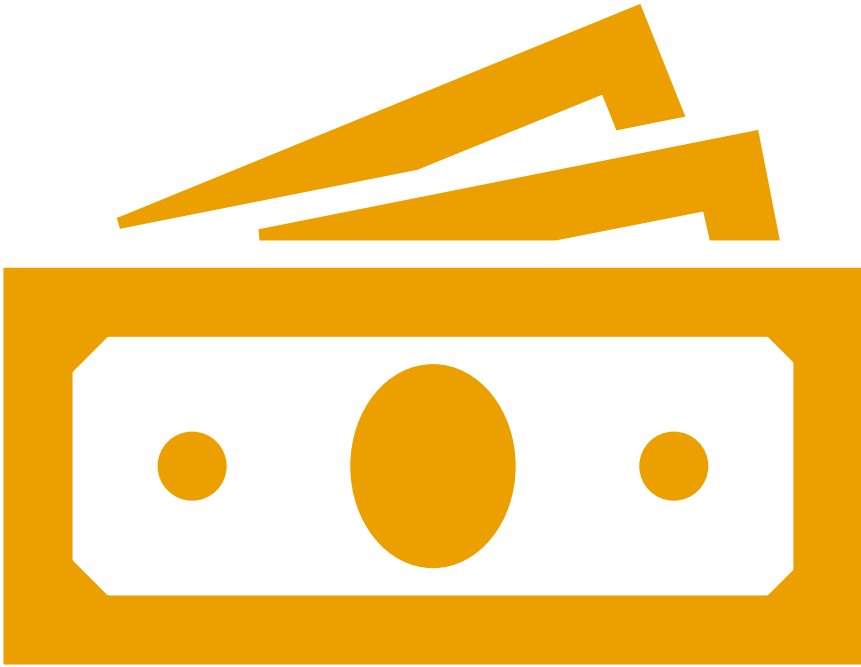
Case Study: Assessing Mr. Tan's Net Worth for Loan Application

Implications for Loan Approval:

- Mr. Tan's strong net worth increases his chances of loan approval.
- However, the bank will still conduct a thorough credit assessment, considering his income, liabilities, and credit history.
- The bank might offer more favorable loan terms due to his strong financial position.

Key Considerations::

- Accuracy of Valuations: Banks will verify the valuations of assets through independent appraisals.
- Liabilities: All Liabilities must be accounted for.
- Documentation: Mr. Tan will need to provide supporting documentation for all his assets and liabilities.



Definition of Capacity

Borrower's ability to generate sufficient income to repay the loan.

Importance of Evaluating Capacity

Ensures borrower has sufficient ongoing income to service loan and interest payments.

Reduces bank's default risks.

Methods of Capacity Evaluation

Salaried employees: Analysis through payslips, CPF contributions, income tax returns (IR8A).

Self-employed: Profit & loss statements, cash-flow analysis.

Definition of Condition

Factors
concerning
specific loan
conditions
including

Key Factors Influencing Loan Conditions

Purpose of the loan

Loan amount

Repayment period

Current economic outlook
and market conditions

Loan Purposes

Unacceptable Loan Purposes (Automatic Rejection)

- Illegal activities: Money laundering, illegal business operations.
- Gambling and speculative investments.
- Regulatory non-compliance: Violating MAS prohibitions.

Acceptable but High-Risk Purposes (Proceed with Caution)

- Loans to finance new ventures outside borrower's usual business activities.
- Debt refinancing or consolidation with strong justification.
- Loans addressing temporary cash-flow issues despite underlying business profitability.

Loan Purposes

Clearly Acceptable Loan Purposes



Purchase of fixed assets: Property, equipment, machinery.



Working capital loans supporting daily operational needs.

Definition of Collateral

Assets pledged as security against loan default.

Purpose: Reduces risk of losses for banks by providing a recovery mechanism.

Qualities of Good Collateral



Easily valued and marketable.



Stability or appreciation in asset value.



High liquidity allowing quick asset sale without significant loss.

Margin of Advance

01

Definition: The proportion of the collateral value that banks will lend.

02

Calculation: $\text{Margin of Advance} = \text{Loan Amount} / \text{Value of Asset}$.

Example: Borrower pledges DBS shares worth SGD 250,000; Bank grants loan at 70% margin, lending SGD 175,000.

Common Collateral Types in Singapore



Residential and commercial properties



Marketable securities (e.g., shares, bonds)



Cash deposits and fixed deposits

Collateral Risks and Considerations



VOLATILITY AND MARKET CONDITIONS
AFFECTING COLLATERAL VALUE.



LEGAL AND REGULATORY
CONSIDERATIONS (E.G., MAS
REGULATIONS ON SECURED LENDING).

Credit evaluation and the risk trade-off



Introduction to Risk vs Return in Credit Evaluation

- Banks evaluate risk versus return when deciding to approve or decline credit applications.
- Higher risk loans typically yield higher returns (interest rates and fees) to compensate for increased risk.
- Effective credit evaluation ensures the bank strikes the optimal balance between profitability and manageable risk.

Understanding Credit Risk

Definition:

The likelihood that a borrower may fail to meet loan repayment obligations.

Role of credit analysis in identifying and mitigating these risks.

Types of risks:

- Default Risk
- Concentration Risk
- Interest Rate Risk

Evaluating and Pricing Loan Risk



Assessment based on
borrower credit profile
and loan specifics:

Credit scores and credit
bureau information
Borrower's repayment
capacity (income stability)
Market conditions and
economic forecasts



Setting interest rates:

Risk-based pricing (higher
risk leads to higher interest
rates)
Factors influencing interest
rate determination (loan type,
borrower profile, market
conditions)

Profitability in Lending


Sources of profit from lending:

- Interest income:
Primary revenue
from loan
repayments
- Fees and
commissions:
Processing fees,
annual fees, late
payment fees

Relationship between risk and profitability:

- Higher risk profiles
justify higher
interest rates to
compensate for
increased risk
exposure.
- Effective risk
management leads
to long-term
profitability.

Alternative data for credit scoring

The background of the slide is a blue-toned photograph of a document. It features a line graph with a jagged, upward-trending line. A silver pen is positioned in the upper right corner, pointing towards the graph. The overall aesthetic is professional and analytical.

Limitations of Traditional Credit Scoring



Dependence on historical financial records.



Exclusion of individuals without previous credit history (new-to-credit consumers).



Ineffectiveness in predicting future repayment abilities accurately in some cases.



Potential biases and limited scope.

Introduction to Alternative Credit Scoring



Definition: Using non-traditional data sources to evaluate borrower creditworthiness.



Objective: Enhancing accuracy and inclusivity in credit assessments.

Benefits of Alternative Data

Enables credit evaluation of individuals with limited or no credit history.

Provides a holistic view of borrower behaviour.

Improves financial inclusion and expands lending to underserved segments.

Types of Alternative Data



Transactional Data: Bank account transactions, utilities, rental payments.



Social Data: Social media activities, professional networks.



Behavioural Data: Online shopping behaviour, browsing patterns, and mobile app usage.

Limitations and Concerns

- Data privacy and ethical considerations.
- Regulatory compliance issues (Personal Data Protection Act – PDPA in Singapore).
- Risk of data manipulation and inaccuracies.



This Photo by Unknown Author is licensed under [CC BY](#)

Practical Examples in Singapore

Grab Finance: Utilising transaction and activity data for driver loans.

Fintech lenders (e.g., Funding Societies, Validus) using alternative data to extend SME loans.

Real-Life Impact and Adoption

Positive impacts:

Increased financial inclusion,
faster credit decisions.

Challenges faced: Consumer
acceptance, regulatory
hurdles.

Future of Alternative Data in Credit Scoring

[Singapore Financial Data Exchange \(SGFinDex\)](#)

[Alternative credit data 101: What it is and what it's used for](#)

[Brankas and CRIF Launch a Credit Scoring System for Borrowers With No Credit History](#)

[Grab and Credit Saison Form Financial Services Joint Venture To Expand Access to Credit for Southeast Asia's Unbanked](#)

[Experian -Alternative Consumer Grade](#)

Summary and Key Takeaways



Importance of comprehensive credit analysis.

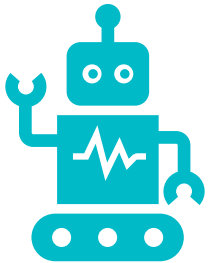


Emphasis on regulatory compliance and ethical considerations.

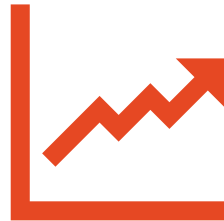


Reiterating the balance between profitability and risk management.

Future Trends in Consumer Banking



Emerging use of advanced technology (AI, Machine Learning).



Increased reliance on alternative data for comprehensive credit evaluation.



Importance of continuous learning and adaptation to regulatory and market changes.



Thank you