INSTRUCTIONAL MATERIAL

FIMA 30063
CREDIT AND COLLECTION

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FIMA 30063 - CREDIT AND COLLECTION

By: Bernadette M. Panibio

INTRODUCTION

This instructional material is intended for exclusive use of BSBA Major in Financial Management students enrolled in the course FIMA 30063 – Credit and Collection.

Knowledge of an effective management of credit and collections information is fundamental to a finance major. For the basics, this material provides an overview of credit and the credit department primarily involved in carrying out the credit and collection functions of an organization. It also covers the entire credit and collection process – from policy formulation to collection and also remedial management of problem accounts.

Assessment questions and activities are also provided at the end of the material to gauge how well the student understood the discussions.

Upon completion of this instructional material, the student is expected to have a clear understanding of the importance of the credit and collection function not only on a personal level but also in an organization. He must also be able to identify the crucial factors that must be looked into in deciding whether to approve or disapprove a credit application as well as how to successfully collect all the extended loans.

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COURSE CODE	**:**	**FIMA 30063**
COURSE TITLE	**:**	**Credit and Collection**
CREDIT UNITS	**:**	**3 units**
COURSE PREREQUISITE	**:**	**FIMA 30023 Banking and Financial Institutions**

COURSE DESCRIPTION

This course covers the discussion of the processes involved in the management of risks associated with lending. As such, it will focus on the basic structure and functions of credit organization and the major aspects of credit management such as credit evaluation, credit investigation, appraisal of properties, account management, pricing of loans, loan documentation, accounts review, collection and remedial management. It will also cover pertinent laws on credit and major trends and issues concerning credit activities in the Philippines

COURSE OUTCOMES

At the end of the course, the learner should be able to:

- Discuss the basic concepts and principles of credit risk management
- Analyze the risks associated with the company's credit policy
- Discuss the internal credit environment of a lender
- Evaluate the credit and collection management process in a firm
- Analyze business and consumer credit profiles to determine credit risk
- Evaluate factors that affect the decision in credit and collection operation
- Formulate control measures in credit and collection management activities
- Discuss social responsibility and ethics as related to credit and collections

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COURSE CONTENT

Week	Topic	Learning Outcomes	Resources/References
Week 1	Introduction to the course contents, activities, and requirements.	Demonstrate interest and appreciation of the importance of knowing the course.	Course Syllabus
Week 2	Overview of Credit • Definition • Nature/Characteristics • Elements • Functions • Classifications and Kinds • Importance • Loan Considerations • Cs of Good and Bad Credit	Recall and discuss basic credit principles Identify the sources and roles of different forms of credit and the responsibilities of different providers of credit Recognize the importance of credit to individuals, businesses and economy Explain the factors to consider in loan extension	Watson. C. 2014. *Introduction to Credit, (*3rd.ed) Sison, N.E.S, 2012. *No-Nonsense Credit and Collection* (4th ed.) www.corporatefinanceinstitute.com www.investopedia.com
Week 3	Introduction to Credit Management • Objectives • Risks Associated with Lending • Structure and functions of Credit and Collection Unit/ Department • Qualities of a credit man	Recognize the relevance of an effective and efficient credit management to the provider and user of credit Identify the risks associated with lending Discuss the principles for the management of credit risk Explain the functions performed by each personnel in the credit and collection department Describe an ideal credit man based on the qualities he must possess	Akkizidis, L. 2016. *Marketplace Lending, Financial Analysis and the Future of Credit: Integration, Profitability and Risk Management* Wiley Agustin, R. *Credit Risk Management* CMAP Apollo, J., *Credit and Collection Management in the Philippine Setting* Basel Committee on Banking Supervision *Principles for the Management of Credit Risk* Brown, K. and Moles, P. 2014. *Credit Risk Management.* Edinburgh Business School Heriot-Watt University

			Credit manuals of financial institutions and other companies www.creditmanagement-tools.com
Week 4	Credit and Collection Policies • Objectives of establishing policies • Factors to consider in formulating policies • Setting of credit limits/lines and terms	Recognize the importance of a well-crafted credit and collection policy Identify the factors dictating for a liberal and restrictive credit and collection policy	Sison, N.E.S, 2012. *No-Nonsense Credit and Collection* (4th ed.) www.abc-amega.com www.bizmove.com
Week 5	Credit and Collection Procedure • Credit and Collection Procedure Flowchart • Target Market Identification • Pre-screening of Loan Applicants	Explain the entire credit and collection procedure Identify client base and credit program facilities that must be pursued Discuss prospecting/account sourcing Identify the factors to consider in pre-screening applicants to distinguish eligible borrowers and projects	Credit manuals of financial institutions and other companies www.bsbbank.com deluxe.com habiletechnologies.com
Week6–8	• Credit Investigation - Purpose - In-house File Verification - Field Verification - Elements • Appraisal of Collateral • Credit Evaluation and Analysis - Ownership and Management - Financial Capability - Industry Analysis - Quality of Collaterals	Describe the financial and non-financial factors to check on credit applicants Identify sources of credit information and the data that can be derived Recognize risk areas and control in appraisal of collateral Differentiate types of collateral	Brown, K. and Moles, P. 2014. *Credit Risk Management.* Edinburgh Business School Heriot-Watt University CMAP, *Credit Investigation Techniques* Credit manuals of financial institutions and other companies Estacio,T. *Credit Evaluation and Analysis,* CMAP www.bizfilings.com www.smartasset.com

	- Condition	Discuss the typical requirements in accepting collateral Appraise the creditworthiness of a loan applicant based on gathered internal and external credit information	
Week 9	**MIDTERM EXAMINATION**		
Week 10	• Loan Packaging Consideration in structuring the terms and conditions • Loan Approval	Identify the factors that must be considered in structuring the terms and conditions of a credit transaction Discuss the items included in loan negotiation such as the tenor, repayment, covenants and security	Credit manuals of financial institutions and other companies Sison, N.E.S, 2012. *No-Nonsense Credit and Collection* (4th ed.) www.sba.gov
Week 11	• Loan Documentation and Disbursement	Recognize the importance of documentation in credit transactions Identify basic documents used in credit transactions	Credit manuals of financial institutions and other companies Sison, N.E.S, 2012. *No-Nonsense Credit and Collection* (4th ed.)
Week 12	• Loan Administration • Credit Review	Recognize the importance of account monitoring and review Discuss the credit support and control systems and other practices necessary to manage outstanding loans	Brown, K. and Moles, P. 2014. *Credit Risk Management.* Edinburgh Business School Heriot-Watt University Credit manuals of financial institutions and other companies
Week13–14	• Collections and Repayments	Discuss the tools and aids in collecting Describe the strategies and tactics of collection	Brown, K. and Moles, P. 2014. *Credit Risk Management.* Edinburgh Business School Heriot-Watt University Credit manuals of financial institutions and other companies

Week 15	• Remedial Accounts Management	Discuss remedial accounts procedure Recognize situations for possible work-out	Brown, K. and Moles, P. 2014. *Credit Risk Management.* Edinburgh Business School Heriot-Watt University Sison, N.E.S, 2012. *No-Nonsense Credit and Collection* (4th ed.) Credit manuals of financial institutions and other companies
Week 16 - 17	The Legal Aspects of Credit and Collection	Identify pertinent laws on loans Recognizesituations needing legal actions	Apollo, J., *Credit and Collection Management in the Philippine Setting* SES Consumers Affair Unit BSP. 2007. *Handbook on Consumer Laws Covering BSP-Supervised Financial Institutions (*Vol.1) Sison, N.E.S, 2012. *No-Nonsense Credit and Collection* (4th ed.) www.bsp.gov.ph www.creditinfo.gov.ph www.sec.gov.ph
Week 18	**FINAL EXAMINATION**		

References

Agustin, R. *Credit Risk Management.* Credit Management Association of the Philippines
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GRADING SYSTEM

Class Standing	70%
• Quizzes	
• Case Study	
Midterm / Final Examinations	30%
	100%

$$\frac{\text{Midterm Grade + Final Term Grade}}{2} = \text{FINAL GRADE}$$

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Week 2 - OVERVIEW OF CREDIT

- Definition
- Nature/Characteristics
- Elements
- Functions
- Classifications and Kinds
- Importance
- Loan Considerations
- Cs of Good and Bad Credit

At the end of the lesson, the student is expected to:

- Recall and discuss basic credit principles
- Identify the sources and roles of different forms of credit and the responsibilities of different providers of credit
- Recognize the importance of credit to individuals, businesses and economy
- Explain the factors to consider in loan extension

OVERVIEW OF CREDIT

CREDIT

- The ability to obtain things of value in exchange for a promise to pay at a determinate future time (debtor's viewpoint)
- Willingness to accept the debtor's promise based on trust and confidence (creditor's viewpoint)

SIGNIFICANCE OF CREDIT

Credit plays a very important role in our present-day economy. It has changed not only the outward physical appearance of big and small communities but also the way of life and the standard of living of modern countries. The extent in the use of credit is also great that it determines the level of political, economic and social life of people today. This is so because credit when properly utilized in right proportion, promotes the functions of the regular medium of exchange.

The use of credit allows the possible production of goods. When business opportunities appear and businessmen forecast profitable market possibilities, businessmen are willing to expand credit. As business opportunities decline, the need for credit also declines because the financial burden accompanying it increases.

Credit plays an important role in the distribution of goods. The role of credit is to provide financial means for businessmen who take advantages of market opportunities in both domestic and foreign markets.

It is also important that we must also recognize the endeavors of both the governmental and the private businesses to promote full employment. The increase in the production of goods and services, which will automatically increase employment of labor, will greatly depend on the businessmen's forecasts of market expectations. Such increase in demand for the product will definitely be influenced by consumer's desire and their ability to fulfill their desire.

Consumer's credit is a vital link between production and distribution. It allows consumers to buy goods and services beyond their ability to buy or what they can actually afford.

ELEMENTS OF CREDIT

1. Trust

From the origin of the word credit which is creditum, meaning trust, it is evident that the first consideration in granting credit would be the presence of trust and confidence.

2. Futurity

A distinct aspect which sets apart cash transaction from a credit transaction is the element of time or futurity. Whether the time is an hour, a day, a month or a year does not matter, provided that payment is after the specified lapse of time.

3. Risk

Since the creditor has only to rely upon the debtor's future performance, there is the element of risk. This is due to the uncertainty of payment of the possible reduction of payment.

CHARACTERISTICS OF CREDIT

1. It is bilateral or a two-party contract

Every debtor has his corresponding creditor; creditor his corresponding debtor. The creditor demonstrates his faith in his debtor by transferring title or ownership of the goods or services solely on his debtor's promise to pay for them later. In turn, the debtor binds himself to pay and the same time recognizes the right of the creditor to collect from his the price of goods and services transferred to him.

2. It is a personal contract

When a loan is extended, the debtor's character is the primary basis. Although the debtor's willingness to pay may be beyond question, another personal element must be considered…his ability to pay

3. It is a pecuniary contract

In order to protect the rights of both parties, the debtor must know the exact amount of his obligations and the creditor must also know the extent of his claims. The most accurate way of measuring these magnitudes is thru the use of a reliable standard of deferred payments which is money expressing such debts or clams by the price involved.

CASES WHERE CREDIT TRANSACTIONS ARISE

- Deferred payment for goods and services.
- Money loans
- For services rendered where individuals receive their wages or salaries after rendering their respective labor and talents or sometimes workers may render their services after receiving their money ahead of time.

ADVANTAGES OF CREDIT

1. **Allows the immediate use of goods and services**

   Use now pay later so to speak. This is especially helpful for big-ticket items such as house and lot, furniture, car, education which few people can afford to shell out cash for.

t2. **Shopping convenience**

   Credit and charge cards allow us to shop and travel without having to carry large amounts of cash.

3. **Provides a temporary solution to unexpected financial difficulties**

4. **It is an agent of production**

   It is an accepted fact that idle funds do not help the economy. With the use of credit, these idle funds are channeled to productive activity. Those people with excess funds deposit them in banks which in turn lend them to businessmen to enable them to produce more goods.

5. **Credit gives fluidity to wealth**

   Because of the presence of secured loans, credit turns fixed assets into current assets. For example, one can get as a loan a certain amount in cash by using a real property as collateral for the loan.

6. **Credit supplement the monetary system**

   The circulation of checks representing bank credit tends to supplement the monetary system by providing other media of exchange.

DISADVANTAGES OF CREDIT

1. **It costs money**

   Purchases paid for over time cost more – often much more than cash

2. **It encourages overspending**

   Credit makes impulsive buying easy. Some consumers go deeply into debt buying items they don't need for the simple reason that they haven't used up their credit line yet

3. **It ties up future income**

   Credit purchases mean less disposable income in the futures

4. **It may result in losses**

   If you fail to make payments on time, you may lose the merchandise. For loans that require collateral, you could lose valuable property

5. **Liberal credit can lead to over-expansion or over-speculation**

    When a business is booming, credit is given fully. This further boosts prosperity. People become extra confident and forgot the possibility of depression. They will be riding on the crest of prosperity. When business suddenly slumps, they are caught unaware and will have to marshal funds to pay their debts.

6. **The government that borrows heavily may have to curtail important projects when most necessary**

CLASSIFICATIONS AND KINDS OF CREDIT

As to maturity

Short-term	-	payable within one year
Medium-term	-	payable from one to five years
Long-term	-	payable for more than five years
Call-loan	-	with indefinite maturity, payable immediately upon the demand of the creditor

As to source

Public	-	granted by government institutions
Private	-	granted by commercial enterprises, banks and other financial institutions

As to payment of interest

Ordinary	-	interest is paid together with the principal on maturity date
Discount	-	interest is automatically deducted from the principal at the time it is granted

As to method of release

Lump-sum	-	the principal is given once to the debtor
Installment	-	the principal is broken down in staggered releases

As to source of payment

Self-liquidating	-	repayment will come from the income derived from the use of the principal
Non-self-liquidating	-	repayment will come from the personal income (salary) of the debtor

As to purpose

Agricultural -	granted to finance agricultural needs such as for irrigation system, acquisition of seeds, fertilizers, and others
Commercial -	used to finance short-term working capital needs such as payment of maturing accounts and purchase of inventories
Industrial -	granted to finance long-term capital needs such as expansion expenditures and acquisition of fixed assets
Real estate -	used to finance the acquisition and improvement of real estates
Personal or consumer-	granted to individuals to facilitate the consumption of goods and services

As to loan user

Agricultural -	farmers, fishermen and others engaged in agricultural activities
Commercial -	wholesalers, retailers, importers, insurers and brokers
Industrial -	manufacturers, processors, and others engaged in the production of goods
Public Utility -	franchise holders and operators of public utilities
Real Estate -	developers, brokers, contractors, condominium owners, purchasers of lots and persons contracting, repairing or renovating their houses
Export -	exporters
Services -	companies and persons rendering professional, educational, medical, recreational services such as schools, hospitals, sports club, law firms and accounting firms
Personal or consumer -	persons who will use the loan for medical, education or emergency needs or for the acquisition of consumer goods such as household equipment and appliance

As to security

Secured -	credit issued with collateral
Unsecured -	credit issued without collateral, also known as character or clean loan

Loan accommodations on a clean basis is usually granted to persons, firms, entities and corporations whose credit worthiness, based on the evaluation of the 5 Cs of credit is highly favorable based on the standards set. The financial capacity, cash flow, liquidity, business profitability and stability of the borrower should be able to justify an accommodation, the repayment of which is solely dependent upon the strength and capability of the borrower.

LOAN CONSIDERATIONS

Purpose

It is important that the purpose for which the loan will be used be productive to enable the borrower to repay the obligation incurred. It should also be useful to the community so it will contribute to the economic development of the region. Speculative loans are frowned upon.

Type and size of loan

Lending involved risks, hence the need to diversify the loan portfolio as a means of spreading the risks. Due consideration should be given to the amount involved because the larger the amount, the greater the aggregate risk.

Maturity

It must always be kept in mind that the longer the time, the greater the risk. Maturity of the loan should therefore be patterned to the duration of the financing needed by the borrower.

Security

To reduce the risks involved in lending, collaterals such as real estate, shares of stocks, receivables, machineries and equipment, inventories and others should be required.

Interest

Several factors should be considered in establishing the rate such as the cost of funds and the account relationship of the borrower with the lender.

Loan Liquidation

Repayment of the loan should be discussed thoroughly with the borrower and carefully considered when the loan is made to avoid possible trouble later. Failure to repay the loan on time impairs the liquidity of the lender's loan portfolio and increases the risk

THE TEN COMMANDMENTS OF CREDIT: THE Cs OF GOOD AND BAD LOANS

<u>The Cs of Good Loans</u>

One of the first thing examiners and lenders is the five Cs of credit. They are the tried and true rules of good loan-making, consisting of ***character, capacity, conditions, capital*** and **collateral**. The five Cs represent the "Thou Shall" commandments of lending.

Character –

Thou shalt make sure that the company or person you are lending to is of outstanding character.

Character refers to the borrower's payment habits and attitudes, that is, his willingness to pay.

Capacity –

Thou shalt be sure that the company or person you are lending to have the capacity to repay the loan.

Capacity refers to the borrower's ability to pay as reflected in his cash flows.

If the borrower is not making money or generating a positive cash flow, odds are there will not be enough money to pay off its debt. In general, borrowing customers have only three sources to draw upon to repay their loans: (a) cash flows generated from sales or income, (b) the sale or liquidation of assets, or (c) funds raised by issuing debt or equity securities. Any of these sources may provide sufficient cash to repay a loan. However, lenders have a strong preference for cash flows as the principal source of loan repayment because asset sales can weaken a borrowing customer and make the lender's position as creditor less secure. Moreover, shortfalls in cash flow are common indicators of failing businesses and troubled loan relationships.

Capital –

Thou shalt make sure that the borrower is adequately capitalized.

Capital refers to the borrower's net worth position relative to his outstanding debts.

This provides a cushion for any losses that may occur and helps to keep the lender from ending up in bankruptcy court haggling over the remains of a dead company.

Conditions –

Thou shalt underwrite all loans understanding that business and economic conditions can and will change.

Conditions refers to economic factors which may affect the borrower's line of work or industry and how changing economic conditions might affect the loan. A loan can look good on paper, only to have its value eroded by declining sales or income in a recession or by the high interest rates occasioned by inflation. The lender cannot predict the future, but being alert will allow him to react to deteriorations in the market quickly, rather than reacting at the bottom of a downturn.

Collateral –

Thou shalt make sure that collateral does not drive lending decisions.

Collateral refers to any asset which may be pledged against the debt.

Credit factors should always be the primary consideration. Having a tangible (that is, seizable) asset backing up each deal means that if something goes wrong, the loan is covered.

The traditional five Cs of credit should be thought of as commandments: Do this, check this, look for that. These rules have worked fairly well in the past, but in recent years, lenders have learned a few more Cs: the five Cs of bad credit.

The Five Cs of Bad Credit

It is necessary to add the five Cs of bad credit – the five things to guard against. Consider these the "Thou Shalt Nots" consisting of complacency, carelessness, communication, contingence and competition.

Complacency

One of the important lessons to be drawn from the past couple of years is to guard against complacency. Many lenders have said something like, "I don't need to worry about the borrower, he has always paid us on time." That is an incorrect assumption.

Overemphasis on past performance is another concern. The old adage that past success does not guarantee future is very true. But it was ignored. How many lenders said, "The last three loans were paid as agreed. Why worry about this one?"

Over reliance on large net worth is yet another concern. "I know him, I know his family. They have borrowed from us for years, he wouldn't default on me." The next thing the lender knows – he or she is sitting in bankruptcy court wandering what happened.

Old loan officers forgot the bad times. It was easy to delude themselves into thinking that they would see another recession, that things would keep booming. As unfortunate as it is, the business expansion and recession is not going to go away.

What about the new loan officers who have only seen the good times? When they do not know what the bad times look like, it is hard to maintain that healthy level of skepticism that they need to be good lenders. What experienced lenders need to emphasize to new lenders is the danger of good times. The danger is that bad times always follow.

Carelessness

It was easy to say, "Don't worry about the loan covenants or documentation. I'll get it later." Well later is here, and there are a lot of loans out there with improper documentation, incomplete financials, inadequate loan covenants, and no one knows where to find the information because the officer responsible is no longer working for the company. Ant it is all because someone was careless.

Inadequate Loan Documentation – A lien needs to be filed on some assets. "Don't worry, I'll file it next week," the officer says. When next week comes, the officer finds out

that another lien was filed between last week and today. Instead of being the first lien holder, the company is now second.

Lack of Current Financial Information – Statements are not updated, appraisals are not completed, and before the lender knows it, a strong real estate developer has negative net worth and her property, which is the collateral for her loan, has declined 50% in value. Many lenders do not even know when this happens because they have not looked at the financials in a year and a half.

Lack of Protective Loan Covenants – Careless lenders sometimes do not put language into the loan agreement that requires a closely held borrower to keep.

Information Not Kept in Files – This is such an easy trap to fall into that everyone is guilty of it to some degree. Many lenders do not document calls or conversations, and the next thing they know they are trying to reconstruct conversations from two years ago because their company is taking the customer to court to recover a loan. Or worse yet, they are being taken to court in a lender liability suit over something they supposedly promised to do. It is easy to avoid these situations – just write the information down.

Communication

Poor communication, up and down the line is deadly.

Unclear Credit Quality Objective – Management must be clear on credit quality objectives. Loan policy is written to provide standards for acceptable and unacceptable loans, but problems arise when no one follows the policies.

Upward Communication – Let's say the front line does not communicate upward. If the officer is meeting the customer, he or she probably knows that a problem exists in a certain industry well before anyone else. Many times, though, the officer will assume that if he or she knows about a problem, everyone knows about it. But that is not true. There must be upward communication.

Unclear Communication by Regulators – In the past, regulators did not always communicate concerns early enough or consistently.

Contingencies

Competition is probably the most important of the five Cs of bad credit.

Lenders started to make decisions because of what the lender down the street was doing, rather than concentrating on the merits of the loaning front of them. They decided to do whatever it took to win business. Unfortunately, that meant making credit standards as loose as, or loser than, everyone else's.

Competitive Euphoria – Lenders decided they were not going to lose deals, no matter what. If a borrower said he could get a loan at prime + 1 at a bank down the street, the banker up the street would offer prime + ½. "I am not going to lose this deal to anyone" was the way to look at it. Maybe the banker wanted to fully collateralize the deal, but the borrower was also negotiating with someone else. So instead, the banker went for 50% collateralization to get the business. The banker's attention was not on loan characteristics, it was squarely on the competition.

The fifth and final C of bad credit is beware of doing whatever it takes to win. Thou shalt not be swept away by competition.

Week 3 - Introduction to Credit Management

- Objectives
- Risks Associated with Lending
- Structure and functions of Credit and Collection Unit/Department
- Qualities of a credit man

At the end of the lesson, the student is expected to:

- Recognize the relevance of an effective and efficient credit management to the provider and user of credit
- Identify the risks associated with lending
- Discuss the principles for the management of credit risk
- Explain the functions performed by each personnel in the credit and collection department
- Describe an ideal credit man based on the qualities he must possess

CREDIT MANAGEMENT

Effective management of the loan portfolio and the credit function is fundamental to a company's safety and soundness. Credit management is the process by which risks that are inherent in the credit process are managed and controlled.

RISKS ASSOCIATED WITH LENDING

Risk – the potential that events, expected or unexpected may have an adverse impact on earnings or capital

Credit Risk

The risk of repayment, i.e., the possibility that an obligor will fail to perform as agreed. The first defense against excessive credit risk is the initial credit-granting process – sound underwriting standards, an efficient, balanced approval process and a competent lending staff. Management of credit risk, however, must continue after a loan has been made for sound initial credit decisions can be undermined by improver loan structuring or inadequate monitoring.

Interest Rate Risk

The level of interest rate risk attributed to the lending activities depends on the composition of the loan portfolio and the degree to which the terms of the loan expose the revenue stream to changes in rates. As part of the management process, borrowers whose loans have heightened sensitivity to interest rate changes should be identified and strategies to mitigate the risk should be developed.

Liquidity Risk

As part of liquidity planning, an overall liquidity strategy should include the identification of those loans that may be easily converted to cash. A loan's liquidity hinges on such characteristic as its quality, pricing, scheduled maturities and conformity to market standards for underwriting. Loans are also a source of liquidity when used as collateral for borrowings.

Liquidity is also affected by the committed amount to lend and the actual amount that borrowers draw against those commitments. There should be systems to track commitment and borrower usage. Knowledge of the types of commitments, normal usage levels and historically high usage levels are important in assessing whether available liquidity will be adequate for normal seasonal or emergency needs.

Transaction Risk

In the lending area, transaction risk is present primarily in the loan disbursements and credit administration processes. The level of transaction risk depends on the adequacy of information systems and controls, the quality of operating procedures and the capability and integrity of employees. For example, an increased credit risk may be incurred when information systems failed to provide adequate information to identify concentrations, expired facilities, or stale financial statements. At times, losses may be incurred because of the failure to perfect or renew collateral liens, to obtain proper signature on loan document or to disburse loan proceeds as required by the loan documents.

Compliance Risk

Lending activities encompass a broad range of compliance responsibilities and risks. For example, a bank must observe limits on its loans to a single borrower, to insiders and to affiliates. It may also become the subject of borrower-initiated “lender liability” lawsuits for damages attributed to its lending or collection practices.

Reputation Risk

When a lender experiences credit problems, its reputation with investors, the community and even individual customers usually suffers. Inefficient loan delivery systems, failure to adequately meet the credit need of the community and lender-liability lawsuits are also examples of how reputation can be tarnished because of problems within its lending division.

CREDIT DEPARTMENT AS A PROFIT CENTER

More and more top managements are treating the credit department not merely as a cost center, but as a profit center as well. The traditional concept is that the credit management is for policing of receivables. The emerging view today is that credit management is tasked with the job of subjecting the investment in receivables to the test of profitability just as we test every other investment. The old approach to “what can credit do for sales” should be discarded and ask the broader, more important question” what can credit do for profits.” When trade credit is extended, you are committing some of the resources of the firm. Credit has its initial impact on sales but the ultimate goal should be to increase profits. The credit executive is presented with unlimited challenge to his abilities. The concomitant establishment of credit policy that will maximize net return from investment in receivable is the most difficult job but, if successfully pursued, top management would not fail to accord it the importance it deserves.

The Credit and Collection Unit

A credit and collection office does not have to be an elaborate one. In fact, it may be started with one or two personnel with adequate background in such work, gradually increasing the personnel in proportion to the volume of credit sales and its consequent increase of amount and number of receivables. The important thing to remember is that from the very beginning when a first credit, loan or investment is made, a credit and collection system should be in effect. It is an axiom in credit that collection is only as good as the credit processing and that the older an account becomes the harder it is to collect. It is important therefore that collection dates should be properly noted immediately and followed up accordingly. And this can be done only if a credit and collection system is in effect.

Credit and collection are two different activities, though they are closely interrelated. The first refers to the processing, evaluation and extension of credit and the latter refers to the activities related to collection of accounts. When credit and collection activities are still small, problem starts when credit business becomes voluminous. The problem that will control top management is: Should credit function be separated from the collection function? Or more, briefly stated should the same set of personnel handle both credit and collection function as their collective responsibility? Or should these functions be separated? The decision will narrow down to the basic question: How trustworthy are the members of the staff? Concentration of both credit and collection functions in one and the same person or set of personnel is a source of great temptation. On the other hand, a centralized setup will minimize, if not totally eliminate, 'buck-passing' of responsibilities would be an easier job. Then, there is the consideration of operating costs. This is especially true if credit extensions are not limited to the immediate territory of the firm and its environs but extend to the provinces or even nationwide. Operating costs would sometimes dictate that a company's provincial credit representative performs
both credit and collection functions. The ultimate decision would lie on the shoulder of top management, which should consider all these circumstances.

It is pertinent to point out the general practice, as it actually exists in the Philippines today. As a general rule, banks, and other allied lending institutions maintain separate sets of personnel for credit and collection. No explicit studies or explanations have ever been made why this is so.

Another big problem that confronts top management in the matter of organizing the credit and collection unit is the question of who will make the final credit decision. Credit managers in some companies, although the title has been bestowed on them, do not make the final credit decision. Theirs are merely recommendatory, the final decision being reserved to a higher official. The reason is that many companies are family-owned and that, therefore, the investors feel a lot secure if the final credit decisions are made by such higher official usually a member of a family-owner. In fact, many credit extensions started merely as accommodation to relatives and friends of the family-owner, gradually expanding to other outsider. Some big outfits with national presence delegate final credit decisions to a "Credit Committee" composed of senior executives.

With the expansion of the credit activities, the problem of who should making the final decisions becomes a very critical matter.

Functions of the Credit Department

All matters related to credit sales and occasionally anything that touches upon credit are among the functions of the credit department. The functions enumerated follow the general aspects of credit managements. Each particular type of business usually suits the activities of its credit department to the nature of its business.

- **Gathering credit information** – Through the credit investigators, the credit department gathers information about the applicant from direct and indirect sources. Sometimes information for policy formulation is also gathered.

- **Analyzing credit information** – All the information gathered is sent to the credit analyst who is in charge of applying the standard tests and measurements for performance. The non-financial data are critically subjected to analytical tools to determine the creditworthiness of the debtor.

- **Credit checking and authorization –** Once the analysis is undertaken, verification is made of the applicant's papers and the proper authorization for credit is given by the authorized officer or committees as the case may be.

- **Filing and recording** – A record of the transaction is made and the credit folder of the applicant is prepared and filed. From time to time, the file or records, or both, whichever is the case, are updated.

- **Credits adjustments** – Adjustments are made in accordance with discount or net credit period, or both. In the case of banks, this may pertain to increasing or decreasing the credit lines, or perhaps extensions.

- **Collection correspondence –** Credit granting does not end with the approval of the application but with its collection. When the credit has been granted, collection follow-up, reminders, and other correspondence are sent to the debtor.

- **Other functions –** Other functions, which may fall within the jurisdiction of the credit department, are the exchange of credit information with other organizations and the dissemination of credit information to valued customers in case of banks. Credit information may also be used by other departments of the organization.

THE CREDIT MANAGER

When a business organization sells on credit, the administration of the credit becomes, on some level, a management function. The type and extent of management required is not the same in different types of institutions not is it always handled in the same way in comparable organizations. The level of management required for the administration of credit in a firm is determined, more than anything else, by the concept of credit prevailing here. In some instances, credit is viewed as a simple function of approving credit transactions. In other cases, as the concept broadens, the credit function embraces sales and finance policy and other top management strategy. The management of credit then becomes a responsibility of a higher order and calls for talent equal to the task. This task is handled by a credit manager.

Credit positions vary according to the importance given to the position by top management. They are identified by countless different titles representing the graduations of authority and combinations of responsibility. On the officers' level, the credit position may be known as Financial Vice President; in lower echelons, the position is designated as Credit

Manager, Assistant Treasurer, General Credit Manager, Branch Credit Manager, Loans Manager, Credit Man, Credit Correspondent, and many other similar titles.

Qualities of a Credit Man (The Cardinal CS of a Credit Man)

Competence and Capability

He should know his areas of responsibilities. He must be aware of institutional viewpoints and correspondingly acts in behalf of the institution as a whole. He should know and understand the goals, objectives and policies of the company, of the other departments in the organization; of his own department which is credit. He must have a clear understanding of what the end points of his efforts are and should be.

Communication

He must have the ability to effectively convey his ideas. This includes the preparation of reports and correspondence and also the delegation of duties and the corresponding authority to subordinate.

Constructiveness

He must be positive and constructive in his approach to both credit and collection management. He must find a way by which credit can be granted and in the process free himself of the negative image of one concerned with finding a way by which credit should be denied.

Creativity

He must keep pace with changing times and changing conditions. He should constantly pursue creative answers to new questions. He must be able to put old ideas together to solve a new problem.

Conscientiousness

He must be devoted and dedicated to his job. He must be a strong proponent of cooperation and coordination in the entire organization.

Consistency

He must be consistent in making credit decisions. He must have a consistent performance which is consistent with company goals and objectives. He must not unnecessarily deviate, nor completely veer away from policies and guidelines to accommodate friendships and other personal consideration.

Certitude and Celerity

He must not only act with certainty and accuracy but also with swiftness and speed.

Contact

He must have good contact, good public relations both within and outside the organization. It is particularly needed in gathering and verifying credit information.

Cost-consciousness

He knows how to minimize cost in credit evaluation, remedial account management and others.

Character

He must have character integrity, reliability and sometimes need to be a "character" to cope with clients who turn out to be ""characters".

Confidence

He must be trusted by the debtor to have reciprocity of confidence between the credit man and the customer

Considerateness

He must have regard for other's feelings. It is incumbent upon the credit man to extend assistance to the customer.

Computer literate

He must have at least some basic knowledge of computers and the ins and outs of information technology.

Congeniality, charming personality, courage

He should be cool and calm and deliberate, but certainly firm and uncompromising when he encounters pressures.

Common Sense

TESTS OF CREDIT DEPARTMENT OPERATIONS

Credit executives have been diligent in seeking and applying quality tests to the credit that they are asked to accept. They have discovered that their investigations must be sufficiently complete to uncover all unfavorable information and to permit proper analysis, must be reasonable from a cost point of view, and must be done with sufficient speed to enable a decision to be reached without causing dissatisfaction. Credit management's responsibility to the firm, the debtor and society having been recognized and the objectives of credit department operations having been clearly stated, the next step should be to measure the attainment of these objectives – to test the manner in which the credit department is meeting its responsibility.

The tools or indexes are designed to provide credit management with some means for testing the efficiency of its credit operations. These tools help credit managers determine whether their departments are bringing about maximum sales and minimum losses. These tests are valuable in many important ways.

1. The periodic calculation of ratios, percentages and other figures is necessary to measure credit and collection results

- Unless this is done, there is no way of knowing just what has been accomplished and what changes have occurred in each of the various aspects of the firm's credit business.

2. Keeping these statistical records makes it possible to set up standards or goals to shoot at in each phase of the credit and collections activity

    - Without standards, there is no basis for judging accomplishments

3. Accumulation of records kept on the same basis from year to year enables to compare current credit and collection performance with that of previous periods and to determine the progress made.

4. If the firm's credit business is large enough to require the time of more than one person, comparisons often may be made between different individuals.

5. May compare results shown in the firm's figures with those reported by other firms.

6. The records may be used in forecasting future trends in credit sales volume, collections and other aspects of the business.

Bad-Debt Loss Index

- The bad-debt loss index was one of the first tests to be developed and still is one of the tests most generally used by credit managers. The relationship is generally shown by dividing bad debts incurred during a period by total credit sales during the same period (**bad debt loss/total credit sales**)

- There is little uniformity in calculating this proportion. Some firms calculate the percentage of bad debts to total sales; others calculate the percentage of bad debt to credit sales. There is no uniform practice as to the time when an account is classified as bad debt. A big margin of error exists because some account may be written off as bad debts shortly after they become overdue, while others may be carried for many months before they are eventually written off. Consequently, a substantial portion of the bad debts recorded for a given year may have resulted from a credit decision or collection procedures in the preceding year. Yet they are compared with credit sales in the current year and *conclusions drawn from the ratio are applied to the current year's credit and collection policies*.

Credit Sales Index

- In all business enterprises it is important to know what percentage of total sales is represented by credit transactions. This percentage or index is computed by dividing credit sales by total net sales. **(credit sales/total net sales)**

Collection Percentage, Days to Collect and Turnover of Receivables

- These tests are included under one heading because they are simply different ways of stating a similar fundamental relationship.

- The collection percentage, which is one of the most commonly used credit control indexes is determined by dividing the total amounts collected during a period by total receivables outstanding at the beginning of that period
(collections made during period/receivables outstanding at beginning of period).

- Another criterion of credit management efficiency is how it uses capital invested in accounts receivable. The rate of receivables turnover is found by dividing the total sales by the average receivables outstanding **(total credit sales/average receivables outstanding**).

- The seasonality of the business is important in determining how to compute the average of the receivables outstanding. The activity of the investment in receivables may be expressed as a rate or in terms of the number of days required for one turn of the accounts. The latter can be computed by dividing 360 days by the receivables turnover rate **(360 days/receivables turnover rate)**.

- Collection percentages, when decreasing show an accumulation of poor accounts or a slackening of collection efforts before the bad conditions become inevitable. These measures of credit activity should enable credit management to detect the effects of unsound policies.

- As with the other indexes, these figures should be compared with those for previous months and with those for the same month of as many preceding years as possible. Such an accumulation of figures over a period of years helps the credit manager to recognize seasonal trends that should be considered in any analysis. Likewise, comparisons with similar firms give some indication of the subject firm's relative standing. As with the other indexes, this information is valuable when broken down into the types of credit accepted.

- These indexes reflect only averages; certain accounts may be falling behind in payments at the same time that overall collection tests disclose a favorable picture.

Number of Accounts Opened

- The credit department's activity is reflected by the number of new accounts it opens during the period in question. This figure indicates the extent to which the business emphasizes credit service and whether or not it is alert

  to opportunities for attracting new trade. The number of new accounts opened may also measure the effectiveness of credit publicity. This figure, together with the acceptance percentage, measures the leniency or strictness of the business's credit policy.

Acceptance Index

- A measure of growing importance is the index or percentage showing the proportion of applicants for credit that are accepted. **(applications accepted/applications submitted)**
- This index varies considerably, depending on the firm's line of business, the leniency or strictness of its credit-granting policies, and the stage of the business cycle.

Past Due Index

- This test of credit management measures the proportion of all past due accounts, in amount or in number. This ratio should be figured in both number and amount because computing both formulas could give a very different picture if one large account is severely past due versus several small accounts past due. It is computed by dividing the total past due by the total outstanding (total past due/total outstanding)
- When this index is computed for several successive periods, it serves as a barometer indicating whether the general trend of poor pay is up or down. If this percentage increases faster than it should at any given time, credit management can take steps to curb the trend or bring it back to its normal position (which can be ascertained from record maintained over a period of years)

Aging of Accounts

- This test is a detailed analysis of accounts – such as not due, 30 days past due, 60 days past due, and *over one year past due*. It stems from the fact that there is a direct and important relationship between the length of time that an account has been outstanding, the rate of collection, and the probable net loss from bad debts. Aging of accounts can be supplemented with a detailed itemized list of overdue accounts, showing both the name and present statues of such accounts. A list of this kind is valuable in authorizing additional requests.

Cost Analysis

- Any final summation of the result of credit department activities should include cost figures. Credit management can make sounder policy decisions if it has accurate knowledge about the cost of operating a credit service and carrying receivables. Bad debts give one such measure, but losses from bad debts are only one item in the credit department's operation. The expense of operating a credit department often exceeds all bad-debts losses. Wages and salaries of people employed in credit and collection activities are then most important single category of credit expense. Other expenses include fees and dues for credit information, rental or purchases of equipment and *charges for outside collection services*

Week 4 - Credit and Collection Policies

- Objectives of establishing policies
- Factors to consider in formulating policies
- Setting of credit limits/lines and terms

At the end of the lesson, the student is expected to:

- Recognize the importance of a well-crafted credit and collection policy
- Identify the factors dictating for a liberal and restrictive credit and collection policy

FORMULATION, COMMUNICATION AND IMPLEMENTATION OF CREDIT AND COLLECTION POLICIES

A **policy** is a general guideline on how to act in ordinary or extra-ordinary situations that recur from time to time, bearing in mind the accomplishment of established company objectives. Policies exist at several levels: company, major division or department policies.

Credit policies are guides in the performance of the credit functions of the company – the granting of credit terms to customers, approval authorities, criteria for credit granting, securities and collaterals, treatment of delinquent accounts and other general guides. Credit policies are:

- Designed to meet credit objectives
- Intended as guide in the implementation of credit transactions
- Minimum requirements under normal conditions, additional controls may be established when appropriate
- Dynamic – must be flexible and responsive to changing conditions
- Helpful in putting order and facilitating transactions necessary to ensure efficient customer service

FORMULATION OF CREDIT POLICIES

The strength of credit power at any time is a function of two factors affecting the credit risk and consequently, the credit policy, namely: **factors external to the risk** and the **factors inherent in the risk**.

External Factors

Business Cycle

The stage in the business cycle is important as it impacts directly consumer and industrial demand, sales, supply, prices, profitability, etc., which in turn affect profit margins and cash flows. Therefore, being aware of the timing of the cycle, where it is and is expected to go, and in what time frame, is a key informational element in evaluating the viability of credit transactions.

Certain business practices and policies that might be successful during a period of prosperity might prove disastrous during a period of depression or recession. The credit policy must change as business conditions modify the credit strength of customers and clients.

Monetary and Fiscal Policies

These represent the two overall tools used by government to conduct its economic policy. These two policies set the framework within which the economy operates influencing the flow of funds, business priorities, jobs, etc.

Monetary policy affects the level of interest rates and the availability of funds which impacts on both the creditors' appetites and those of their borrowers for funds. When times get tight, marginal customers often get into trouble. When times are easy, companies especially young growth companies often get highly leveraged.

Fiscal policy influences the channeling of funds and spending patterns. Changes in government spending directly or indirectly impact the borrowers' businesses.

Political

The environmental climate needs to be kept in mind as swings in priorities may affect the borrower. Environmental issues such as pollution control requirements can mean higher production costs affecting profit margins; "consumerism" policy/regulations can change a borrower's fortunes; labor instability can result in loss of production affecting a drag on the economy.

Regulatory

This area speaks for itself. What needs to be aware of here is pending or probable regulations affecting the business community.

Industry

One must be aware of industry practices which have a bearing on the credit policy of individual member companies in the industry.

Internal Factors

Over-all Company Objective

By definition, policies are general guides to recurrent situations, bearing in mind over-all company objectives. Thus, over-all company objectives are underlying factors to be considered in developing credit policies.

Other Department Policies

The credit policies should be harmonious with established policies of the other departments within the company.

Financial Condition of the Company

Financial condition of the company has much to do with the amount of credit exposure the company can take. If the creditor's financial condition is strong, the management is efficient, and productive distributive ability is superior, the firm will probably enjoy a wider profit margin; thus, it would be possible to adopt a more liberal credit policy.

Accounting Procedure

Measurement of the credit department's efficiency and collection procedures needs a thorough knowledge of the firm's accounting system.

- Bank credit policies cover loan functions and include types and amounts of loans, basis of loan extensions, kinds of collateral within the purview of the General

Banking Act. While bank loan policies aims for a fair return on investments, they should have for their primordial objectives the protection of the depositors' funds. The bank's income is derived substantially from the activities of the credit department. Thus, the credit departments of banks are more organized and they receive top management attention. However, credit policies of firms other than banks and financial institutions especially trading firms are geared more to support sales.

- The extent of the details of credit policies vary from one company to another. They may be written or unwritten. Although unwritten policies may be workable in certain firms, written policies have distinct advantages as follows:
    - Communicates to employees working in the loan department what procedures they must follow and what their responsibilities are.
    - Helps the lender move toward a loan portfolio that can successfully blend multiple objectives, such as promoting profitability, controlling risk exposure, and satisfying regulatory requirements.
    - Provides rules, regulations and procedures necessary for consistent credit/sales management operations
    - Avoid unintentional changes caused by varied opinions on credit
    - Useful tool in training programs

The most important elements of a well-written credit policy are:

- A goal statement for the loan portfolio (i.e., statement of the characteristics of a good loan portfolio in terms of types, maturities, sizes and quality of loans)
- Specification of the lending authority given to each loan officer and loan committee (measuring the maximum amount and types of loan that each employee and committee can approve and what signatures are required)
- Lines of responsibility in making assignments and reporting information within the loan department
- Operating procedures for soliciting, reviewing, evaluating and making decisions on customer loan applications
- The required documentation that is to accompany each loan application and what must be kept in the lender's credit files (required financial statements, security agreements, etc.)
- Lines of authority within the lending company, detailing who is responsible for maintaining and reviewing the credit files
- Guidelines for taking, evaluating and perfecting loan collateral
- A presentation of policies and procedures for setting loan interest rates and fees and the terms for repayment of loans
- A statement of quality standards applicable to all loans
- A statement of preferred upper limit for total loans outstanding (i.e, the maximum ratio of total loans to total assets allowed)

- A description of the lender's principal trade area from which most loans should come

- A discussion of the preferred procedures for detecting, analyzing and working out problem loan situation

Policing the Collection Function

In every business entity which is engaged in the grant of credit, granting credit is only one phase of its major activity; collection is another. The job of collection is to get the money due to the company. However, all collection efforts should be made in line with the policy of the business firm, that is, collection costs must be kept within reasonable limits, goodwill of customers must be cultivated and maintained and risks must be reduced to the minimum.

Setting Collection Goals and Objectives

The conditions of the economy and industry will also have much to do with the collection goals. Obviously, the collection department will aim for maximum collection. Ideally, a maximum and periodic collection is the target of every business institution.

Developing Collection Policies

Policy should be reviewed regularly as conditions change, and company requirements warrant. Policies are covered by certain factors such as:

a. Terms of Loan or Sale
b. Time Intervals in Collection – when should the initial collection be made and the interval of the follow-up
c. Classification of Debtors – good risk, fair risk, poor risk
d. Nature of the Business – Collection methods and practices differ with the line of trade and methods of operation. Example: creditors with a high income clientele tend to be more lenient than those with low income clientele. More established creditors are stricter than those who are less established who seek patronage to credit liberality
e. Profit Margin – The wider the profit margin, the more liberal is the collection policy. Both the risk and cost involved in diverse collection system must be related to the profit margin and care must be taken that amounts collected do not exceed the cost of collection
f. Nature of Competition – If he encounters a strong competition, a creditor is compelled to adopt policies that would minimize costs

- Successful collection depends upon a systematized collection process which involves a methodical pre-planned program adapted to differing collection needs and providing uniform treatment for similar cases. The procedure must include collection from delinquent accounts. The system must also provide flexibility due to differences in the classes of debtors and customer personalities

Communication of Credit and Collection Policy

The credit policy should be stated in clear and unmistakable terms so that it will be well understood by all who will be directly or indirectly affected. An internal information drive should be launched from time to time, as the occasion demands with the objective of inculcating upon all those concerned the need as well as the importance of giving meaning the substance to such policy through its effective implementation. If necessary, outside parties may be advised of these policies insofar as they are affected.

Implementation of Credit and Collection Policy

Once the policies have been formulated and communicated, they have to be implemented. This involves assignment of responsibilities and authorities, establishing procedures and controls, feedback and reports.

No policy achieves maximum effectiveness unless it is accompanied by a periodic check-up to insure its proper implementation and ascertain its weak spots. By having an established credit policy, a program is made possible against which actual performance and practices can be evaluated for purposes of determining variations if any. Any exceptions to the written credit and collection policy should be fully documented and the reason why a variance from the credit and collection policy was permitted should be listed.

While any written credit and collection policy must be flexible due to continuing changes in economic conditions and regulations, violations of credit policy should be infrequent events.

Example of General Credit Policies

1. The institution shall ensure that all credit facilities extended to its clients are in accordance with all applicable laws and Bangko Sentral ng Pilipinas (BSP) regulations and shall follow all duly approved internal policies and procedures.

2. Generally, lending assistance shall be directed towards established entities, which have demonstrated profitable operations over the last three (3) years.

3. Credits granted should be geared for well-rounded long-term relationships instead of one-time transactions. Profitability results from the deliberate identification, development and cultivation of additional business opportunities with clients the Bank knows well.

4. The institution shall lend for business purposes such as for working capital requirements or fixed asset acquisition/construction, making certain that the activities financed are

transactional or self-liquidating in nature in order to insure a dependable source of repayment. Loans shall only be extended when a borrower can agree in advance to a repayment program related to a realistic appraisal of ability to pay.

5. The Bank shall endeavor to maximize lending for short-term, or for such a period of time and amount, which shall be adequate to complete a self-liquidating business transaction, provided that the maturity shall remain within 360 days.

6. For established and acceptable clients with proven track records, the institution shall also consider medium and long term lending. Such medium/long term loans shall be subject to an amortization schedule and shall be fully secured by acceptable assets.

7. To the extent that loanable funds allow, the institution shall consider viable project financing to assist in the country's economic development.

8. Each account shall be subject to a profitability analysis (APA, account profitability analysis or RORA, return on risk assets) to ascertain that the yields expected from the proposed financial package are attuned with the profit objectives of the Bank.

9. The institution shall encourage the active marketing of its multi-product services through the use of its foreign and domestic letters of credit, drafts, trust receipts, acceptances and promissory notes. Institution seeks to play an active role in financing international trade and to the extent feasible, establish responsive lines of credit for its valued clients.

10. Aggregate institution exposure to a company or group of related companies shall be limited to such an amount as Bank management deems prudent, but not to exceed BSP's Single Borrower's Limit (SBL).

    By policy, the total liabilities of any person, company or corporation or firm, to the Bank for money borrowed, excluding the following loans shall at no time exceed 25% of the unimpaired capital and surplus of the Bank:

    a) loans secured by obligations of the BSP or of the Philippine Government;

    b) loans fully guaranteed by the government as to the payment of principal and interest;

    c) loans fully secured by US Treasury notes and other securities issued by central government and central banks of foreign countries with the highest credit quality given by any two internationally accepted rating agencies;

    d) loans to the extent covered by the holdout on or assignment of deposits maintained in the lending bank and held in the Philippines;

e) loans and acceptances under letters of credit to the extent covered by margin deposits; and

f) other loans and credits, which the Monetary Board may, from time to time, specify as non-risk assets

The total liabilities of a borrower may amount to a further increase of ten percent (10%) of the net worth of such bank: provided, that the additional liabilities are adequately secured by trust receipts, shipping documents, warehouse receipts or other similar documents transferring or securing title covering readily marketable, non-perishable goods, which must be fully covered by insurance. Loans of the following should be aggregated and should be subject to the single borrower's limit:

a) In case of co-partnership or association, the liabilities of the members thereof;

b) In case of a corporation, all liabilities of all subsidiaries thereof in which such corporation owns or controls a majority interest;

c) All liabilities to corporations owned or controlled by the same family group or same group of persons;

d) Loans to individual clients across business activities.

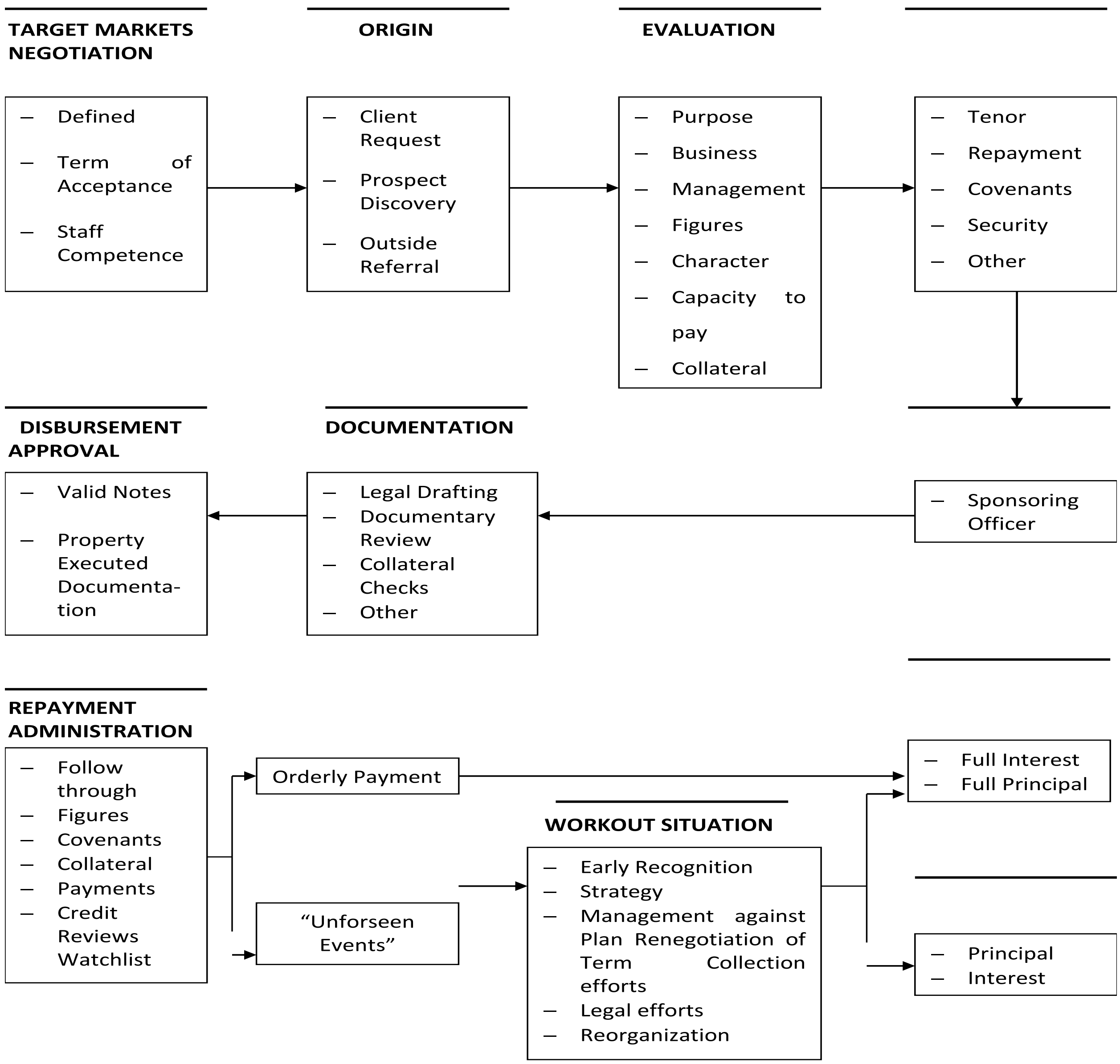
Week 5 - CREDIT AND COLLECTION PROCEDURE

- Credit and Collection Procedure Flowchart
- Target Market Identification
- Pre-screening of Loan Applicants

At the end of the lesson, the student is expected to:

- Explain the entire credit and collection procedure
- Identify client base and credit program facilities that must be pursued
- Discuss prospecting/account sourcing
- Identify the factors to consider in pre-screening applicants to distinguish eligible borrowers and projects

PROCESS FLOW CHART



CREDIT AND COLLECTION PROCEDURE

TARGET MARKET IDENTIFICATION

Target market identification is a process where the lending unit identifies the client base and credit program facilities it will pursue. It is done cognizant of the general policy, program thrusts, strategies and targets of the company, the business environment, market information, present portfolio mix, risk asset acceptance criteria and resources of the lending unit.

Account origination or prospecting refers to the introductory and exploratory discussions the account officers do in relation to credit initiation. It is when the account officer introduces the products and services that may be relevant to the prospective client. Before any origination exercise is done, it is advisable that the account officer secures relevant information on his prospects including financial and related interests. Thus, it requires good staff work and preparation.

PRE-SCREENNG PROCESS

Receipt of Credit Application

The first activity in the Credit Department as it starts actual operation of its functions is the credit application. It must have a credit application form for use by its prospective customer/client. As a matter of policy, no credit extension should be approved and released, unless the customer/client had at least filled up a credit application form. The duly filled credit application provides the credit department.

1. With initial credit information on which to base its credit decision, if credit decision has to be made without further credit investigation
2. Information on which to further interview the applicant
3. With some “leads” on which to start the credit investigation process

In order to guide the credit applicant, it would be good practice to give a listing of the company requirement upon his signifying his intention to apply for such a credit accommodation or loan. This way he will be able to find out whether he could comply with the company’s requirements. The following documents normally should be submitted together with the duly accomplished loan application.

Individual

1. Latest Income Tax Return
2. Marriage Contract (if married)
3. Photograph

Single Proprietorship

1. Business Information Sheet
2. Certificate of Business Name Registration with the DTI
3. Income Tax Return
4. Audited Financial Statements
5. Statement of Assets and Liabilities
6. Photograph of principal/owner

Partnership/Corporation

1. Business Information Sheet
2. Copy of Registration with the SEC
3. Articles of Incorporation and By-Laws (for corporation)/Articles of Co-Partnership and Partner's Resolution (for partnership)
4. List of Officers and Directors certified by the Corporate Secretary
5. Bio-data/Personal Information of Officers and Directors
6. Alien Registration Certificate of foreign officers
7. Audited financial statements
8. Board Resolutions to borrow or enter into the requested facility in the amount of, and designate authorized representative to negotiate and sign in behalf of the company

- The requirements are by no means complete. The account officer, however, should ask for other requirements for them to better evaluate the proposed credit transactions. Therefore, the list may be expanded/shortened depending on the industry/project.

PRE-SCREENING

Pre-screening is done by taking a cursory review of the application whether this is accurately and completely filled up and determined thru preliminary interview whether or nor the applicant is qualified. The interview is conducted to obtain, confirm and verify information about the applicant which is sufficiently reliable, acceptable, and complete to facilitate sound credit decisions. In many cases, the credit interview may not be enough to accumulate adequate and complete information. In which case, a full blown credit investigation will have to be conducted. If the applicant is not qualified, discuss to the applicant the reasons for his disqualification.

Week 6 – 8 CREDIT AND COLLECTION PROCEDURE

- Credit Investigation
  - Purpose
  - In-house File Verification
  - Field Verification
  - Elements
- Appraisal of Collateral
- Credit Evaluation and Analysis
  - Ownership and Management
  - Financial Capability
  - Industry Analysis
  - Quality of Collaterals
  - Condition

At the end of the lesson, the student is expected to:

- Describe the financial and non-financial factors to check on credit applicants
- Identify sources of credit information and the data that can be derived
- Recognize risk areas and control in appraisal of collateral
- Differentiate types of collateral
- Discuss the typical requirements in accepting collateral
- Appraise the creditworthiness of a loan applicant based on gathered internal and external credit information

CREDIT INVESTIGATION CONCEPTS

The concepts and procedure defined in this CMS and the succeeding ones are mere guidelines and are not intended to be all-inclusive. The credit investigation and the credit analyst must rely on their experience, initiative and judgment in determining the credit information necessary in each case.

Purpose of Credit Investigation

- To validate data about a loan applicant/borrower.
  - Credit investigation may also be done on third parties intending to establish a business relationship with the bank such as new depositors, other financial institutions and job applicants.
- To gather, develop and analyze enough relevant information about the borrower to aid in formulating a sound credit decision.

Credit Investigation is conducted on all credit applications to immediately ascertain applicant's credit worthiness. It is intended to detect and eventually prevent extension of credit to applicants with already unfavorable credit records. It covers in-house credit file verification and field verification.

In-House File Verification

All credit applications except those rejected outright are checked against existing credit and court case records.

In house file verification consists of the following:

- *Credit File Verification* – involves inquiry from existing credit records to determine if an applicant has past or present credit transactions with the company
- *Court Case Verification* – involves inquiry against compilation of names of persons against whom collection cases have been filed by creditors

In-house verification is always conducted on borrower's personal name, known aliases, trade or business name and also covers the following:

- Spouses. In case of married individuals, check on both the spouses whether or not one has entered into any credit transactions.

- Co-maker, co-buyers or guarantor whether individual or business entity
- Self-employed borrower, proprietorship or partnership check under both personal and trade/business name
- Individual applicant employed in family-owned firm, verification also covers the company
- Corporate accounts, verification is done on both corporate entity and owners/stockholders

The name gathered as a result of in-house file verification must be ascertained to be of the same identity as the borrower or name of persons indicated in the credit application as co-maker, guarantor, surety, etc.

If the credit investigator has information that the name of the applicant is the same person as the name of a defendant in a court case, he should pursue his investigation to determine whether the applicant is the same defendant in the case

Field Verification

Field verification consists of the following:

- *Residence/Neighborhood Verification* – refers to the inspection of applicant's residence address or locality and verification with the nearest neighbors and store owners in the vicinity to gather information regarding the applicant's background and reputation. It is conducted to:

  - Verify the applicant's and spouse's correct name including their middle names, aliases, ages and citizenship and likewise of their children
  - Verify the respective provincial addresses if there's any
  - Determine house description with approximate lot and floor areas
  - Verify and confirm the exact residence of client
  - Determine the applicant's length of stay in the said address
  - Determine if client owns a vehicle and other household appliances
  - Determine the character of the client based on his reputation in the neighborhood and whether or not he is known thereat
  - Determine the client's general living condition and type of neighborhood
  - Determine the personal data/background of the client
  - Determine if the house is rented or owned by the client
  - Determine the number of children, their age and the school they are attending
  - Determine the income bracket of the applicant and the spouse

- *Business Verification* – refers to the verification of information related to the applicant and related interest business. It is conducted to:

- Confirm/verify the nature of subject's business, its legitimacy of operation and the profitability of the business, the exact address and position of the applicant
- Know the form of organization and type of business of the applicant
- Confirm if business is registered or not with respective government agencies
- Check the business history including the date when it was organized, years of operation, number of employees, major line of business, its major products and/or services, major customers or clients, suppliers and bank accounts with specific brand and account numbers
- Check the neighborhood to determine the character of the client
- Inquire from the administrator of the building if the client is holding business therein and the paying habits of the client
- Compare financial information from the accountant of the business or owner against documents presented and other records that are related to the business
- Check the business premises, if it is owner or rented. Its present locality and condition
- Check if the business has branches or affiliates, fixed assets and fixtures, financial status which includes average monthly sales, receivables, inventories, capital, liabilities, average monthly income and last year's sales

▪ *Employment Verification* – refers to gathering of additional or confirmation of information related to the applicant's job. It is conducted to:

- Determine client's employment status
- Determine length of stay with current employer
- Confirm position
- Confirm compensation
- Confirm client's residence address

▪ *Trade and Bank Verification* – determines the character of the client and his paying habit thru creditors. It determines the following:

- Applicant's accounts maintained with banks whether it is under current or savings, the dates accounts were opened
- Average daily balance (ADB)
- Present balance
- Status of accounts (if it is active or dormant)
- Bank's experience in dealing with applicant

ELEMENTS OF CREDIT INVESTIGATION

Individuals

Identity of the Borrower

- The identity of the borrower should be firmly established. The Bank should know who it is dealing with. Legally, the Bank cannot enforce its claim against a fictitious person or a person claiming to be somebody else. Further checking should proceed only after the identity has been accomplished.

- Information should be obtained about the borrower's age, health, character and reputation, family life and relationships and his residence. These are sources of social pressure which may affect the ability of the borrower to repay a loan.

- Age of an applicant can affect his credit behavior. Young applicants should be fairly established in employment or business and exhibit ability to handle their financial affairs before incurring a loan. The remaining productive years of senior applicants must also be determined.

- The health of a borrower must also be investigated because this will affect his ability to work and generate income to repay his obligations.

- The general reputation of the borrower should be established through residence and employment checking. This should cover habits and morals, his steadiness and dependability, his ability to manage his affairs, his general attitude toward contractual obligations and whether he is living within his means or not.

- The marital status of the applicant is a good indicator of the applicant's stability. A stable family life is a good credit indicator as the borrower will certainly not do anything which will upset this situation. A creditor lending to a family on the verge of breaking up is almost certain to have collection difficulties.

- The personal circumstances and status of the borrower's dependents should also be investigated as this determines the demands on the borrower's income.

Purpose and Motivation of the loan

- The intended use of the loan should be established; if used for unproductive purposes, the sources for repayment of the loan may be diminished.

- BSP manual of regulations require that the purpose for a loan should be indicated in all loan transactions.

- Use of the loan other than for the intended purpose is an Event of Default which will legally allow the bank to demand immediate repayment of the loan.

Source of Income

- The amount, regularity and expected continuity of the income as declared by the borrower should be established. Information should be gathered not only on the borrower but also on the income provider – the employer and the business firm, in case of self employed individuals.

- Demands on income such as living expenses and obligations with other creditors should be fairly calculated. It should be determined whether the borrower can still shoulder the additional debt burden of the proposed loan transaction with the Bank.

- The borrower's financial condition/net worth should be evaluated to show assets available as reserves in case of liquidity problems. The size of the assets is also a determinant of the borrower's thriftiness or the propensity to accumulate savings and credit patterns.

Credit History and Paying Habits

- The borrower's payment record on existing and past debts is an important predictor of credit behavior. Information to be obtained should include court cases, litigation, bankruptcies and repossessions involving the borrower.

<u>Corporate Borrowers</u>

Type of Corporate Borrowers and Focus of CI

1. Small/Family Held – CI shall also include on the owners similar to the CI for self-employed individuals.

2. Big Corporations with Diversified Ownership – CI is centered on the amount of debt, credit history, cash flow and capability of the applicant firm.

3. Corporation with Subsidiaries/Affiliates – Apart from the borrower-firm, CI shall also include the subsidiaries and affiliates particularly if a big portion of the parent company's income/cash flow comes from subsidiaries and/or the parent company has guaranteed a major portion of the subsidiaries debts.

Identity and Motivation of the Borrower

- The CI should first establish whether the corporate applicant is a duly registered entity with the Securities and Exchange Commission. An unregistered corporation has no legal identity and no capacity to enter into contracts.

- In reviewing the corporate papers, the CI should be familiar with the powers of the corporation under its Articles of Incorporation and the powers of its officers/directors under the By-Laws. There could be certain restrictions on the powers of the Corporation and its officers/directors that may affect their capacity to enter into loan transactions.

- The purpose of the loan should also be reviewed against the corporate powers and generally should redound to the benefit of the corporation.

- A profile of the people behind the corporation – incorporators, stockholders and principal officers – should also be obtained as a gauge of management strength.

Source of Income

- Data should be obtained about the present operations of the applicant in terms of major product lines, suppliers, clients, market area and competitors. First-hand information should also be obtained about the corporations' major facilities and assets.

- The present and past financial condition of the firm should be evaluated. The structure of the assets, liability and capital should be adequately scrutinized.

- The stability of ongoing operations and the probability of continuance on a long-term basis should be established by obtaining data about –

    - Financial performance and operating results
    - Comparison of performance versus competitors
    - Projection of financial condition and financial performance
    - Cash flow projections
    - Future prospects of ongoing businesses
    - Feasibility study and analysis of project to be finance

Credit History and Paying Habits

The corporation's dealings with other creditors and suppliers will serve as predictor of future credit behavior. Court cases particularly those involving sum-of-money cases against the corporation are indicators of poor paying habits.

SOURCES OF CREDIT INFORMATION

Data sources are commonly classified as internal and external sources of information.

Internal sources of information are those generally provided by the applicant such as data from the Loan Application and Personal Interview. Data obtained from these sources must be cross-checked before accepting such to be authentic.

- Borrowers tend to withhold certain information that would result in a rejection of his loan application. This may also apply to other sources who may have an interest in the loan being applied for.

  Illustration:

  In cases where refinancing is involved, the present lender of the applicant may state that the applicant has good credit, even if this is not true so that the loan is transferred to the Bank thereby relieving the first lender of his collection problem.

  When a person is asked for references, he will carefully select from his potential list those names likely to give favorable replies.

  The predictable bias from these sources should impel the skillful investigator to develop evidence from informants not supplied by the Borrower. In addition, the questions asked must be specific so that informants are induced to reply factually, rather than being vague by giving loosely stated opinion and judgments or by not mentioning unfavorable points.

External sources of information are independent data obtained from parties or sources not related to or within the control of the subject-applicant such as Negative Data Files, Bank Checking. These data are however not readily available and proper contacts must be developed for this purpose.

Internal Sources

Loan Application Form

This form provides general information about the Borrower. The information supplied by the Borrower is treated as statements of facts which have not been verified.

Personal Interview

This provides an opportunity to obtain supplementary information of the data provided in the Application Form and determine “leads” that will be used in the credit investigation.

Financial Statements (3 years)

These will show the applicant’s –

- liquidity position – ability to meet day to day current obligations
- solvency – determines dependence on financial support from creditors
- managerial efficiency – ability of the firm to operate profitably and successfully for a long time.

The CI should watch out for signs of *window-dressing* or the misstatement of accounting information to reflect a better financial condition than what it is actually is e.g. non-existent or bloated asset accounts, understated or undeclared obligations. This is particularly true for unaudited or in-house financial statements.

A minimum of three years financial statements should be required to enable the CI to establish the trend or pattern in the subject's financial position.

References

These provide supplementary information about the identity and general integrity of the applicant.

External Sources

Neighborhood and Residence Checking

This should confirm the address of the applicant, the length of residence and status as owner or tenant of the property. The relationship of the applicant with neighbors will provide clues about the identity, character and financial condition of the applicant.

Negative Files

The Bank's Customer Information File (CIF) System provides data on accounts blacklisted by the Bank due to mishandled deposits and bad loan accounts. In addition, the Bank relies on the following external sources of negative credit data:

Bankers Association of the Philippines (BAP) – provides the following:

- current accounts closed by member banks due to mishandling
- court cases – venue, sala and reasons for such actions thru the Credit Management of the Philippines (CMAP)
- cancelled credit cards
- credit dealings with member banks thru the Loandex System

Credit Information Bureau, Inc. (CIBI) – this provides information on credit history of applicant with banks and other financial institution, negative data and complete CIR works.

Public Records and Filings with Government Institutions

Government agencies such as the Securities and Exchange Commission (SEC) and Department of Trade and Industry are sources of information about applicants doing businesses.

Articles of Incorporation, By-Laws, Minutes of the Board Meetings and Audited Financial Statements are required to be filed with the SEC.

Employer

This will provide information about type of work done, amount/trend of wages, status of employment and chances for advancement, behavior in the office and relationship with co-employees. Existing obligations with the company should also be inquired on.

Similar information may also be obtained from former employers including the reason for subject's departure from the company.

Income Tax Returns (3 years)

These provide data on sources and trend of income once validated as correct by the BIR or the filing agent. This will also confirm the marital status and the number of dependents of the applicant. For applicants availing of the itemized deduction scheme, data on interest expense can provide leads as to the present debts of the applicant.

Banks and Other Financial Institutions

These will provide information on the amount/status of the applicant's debts and paying history. The general reputation and financial condition of the applicant may also be obtained since these entities also have conducted their own credit checking on the subject.

Trade References

The volume of business done with these firms will give an indication of the reasonableness of income figures and the status of business operations of the applicant. The credit history with suppliers will also indicate if the applicant is a good payor or not.

Transfer Certificate of Title

Annotations on the TCT will locate the previous creditors of the Borrower, wherein we could inquire from them their experience with the Borrower.

Top 1,000 Corporations

This provides information on sales/net income figures, industry and company profiles.

Plant Visit

This gives an insight on how an applicant –firm conducts its business and its production process. Business prospects and operating problems can also be learned from discussions with officers and employees on the site. This will also confirm reasonableness of financial figures presented in the financial statements and loan application.

The Confidential nature of credit information must be safeguarded at all times. All personnel involved in gathering credit data must exercise due care not to reveal the identity of sources of information to the subject of inquiry or other outside parties.

SOURCES OF INFORMATION AND DATA THAT CAN BE DERIVED

Sources of Credit Information	**Derived Data**
1. Loan Application Form	• Subject Property – Location of Property – Developer/Seller – Registered Title Owner – TCT/CCT No. – Lot Area – Purchase Price/Outstanding Balance – Description of Improvement • Borrower's Information – Borrower's personal information and employment record – Spouse's personal information and employment record – Previous Employment of Borrower and Spouse – Monthly Income & Expenses of Borrower & Spouse • Other Properties Owned – Real Properties – Vehicles • Financial Information – Credit Cards – Other Credit Dealings – Bank Accounts
2. Transfer Certificate of Title	Annotations on the TCT will locate the previous creditors of the Borrower, wherein we could inquire from them their experience with the Borrower
3. Personal Interview	The interviewer reviews the Loan Application form and request the Borrower to provide supplemental information, which would assure completion of the blanks not filled in or which probes more deeply into questionable areas.
4. Residence and Neighborhood Checking	• Borrower's Address • Length of Residence • Number of Household Members • Status of Owner or Tenant of the Property • Reputation with Neighbors • Reputation with the Landlord

5. Income Tax Returns (3 years)	• Borrower's source of income • Amount of income • Trend of income for the last 2 years • Civil status • No. of children • Major categories of allowable deductions
6. Employer	• Position of the Borrower • Amount of income • Length of time employed • Reputation with Employer and Co-employees

APPRAISAL OF COLLATERAL

Collateral refers to the property/ies which the borrower puts up to repay a loan in cases of default, or any undertaking from other credit worthy entities to guarantee the borrower's obligation.

- ❖ The borrower's capacity to pay shall always be the primary consideration in the extension of credit. However, endeavor to have a fallback or a secondary source of repayment in the form of value adequate and legally enforceable collateral/security
- ❖ The strength of the collateral is measured and represented by the quality of the assets the lender holds and the completeness and enforceability of all supporting legal documents
- ❖ All collateral/security accepted shall be properly documented and registered/notarized in favor of the lender

Appraisal is an estimate or opinion of value usually transmitted in writing of adequately described property as of a specified date supported by presentation of analysis of factual and relevant data. It is conducted to affix a value on a property or properties offered as collateral to secure a loan accommodation. The value most commonly sought in an appraisal is market value.

Market value may be defined as the highest price estimated in terms of money which a property will bring if exposed for sale in the open market, allowing a reasonable time t find a purchaser who buys with knowledge of all the uses to which it is adapted and for which it is capable of being used. Frequently, it is referred to as the price under which a willing seller will sell and a willing buyer will buy, neither being under abnormal pressure.

General Considerations in the Choice of Collateral

- Stability of value
- General purpose use
- Liquidity/salability
- Ease of documentation
- Control over collateral

Risk Areas and Control in Appraisal

- Proper identification of property appraised
- Authenticity of titles/documents – verification with respective government agencies concerned
- Approaches to values – determination on whether subject for appraisal/inspection is income productive or not
- Reliability of information gathered
- Time and resource management
- Confidentiality of report

Requirements for Collateral

Real Estate Mortgage

- Photocopy of the Transfer Certificate of Title (TCT)/Original Certificate of Title (OCT)/Condominium Certificate of Title (CCT)
- Declaration of Real Property/Tax Declaration
- Tax Clearance or latest copy of Real Estate Tax Receipt
- Location Plan and Vicinity Map signed by Geodetic Engineer
- Insurance
- If corporation – a copy of the board resolution duly executed and acknowledged indicating the names and positions of authorized signatories to the mortgage

Chattel Mortgage: Motor Vehicle

- Proof of ownership
- Chattel Mortgage contract duly registered with the Register of Deeds
- LTO Certificate of Registration and Official Receipt (current) of motor vehicle
- Stencil of Motor and Body Number of Motor Vehicle
- Property listing including detailed description, location and purchase cost

Purpose and Importance of Title Verification

- To ascertain that the borrower is the true and legal owner of the property
- To determine any restriction/encumbrance registered and annotated on the tile
- To determine authenticity of the title being offered as collateral

Types of Collateral

Primary Collateral

- Real Estate Mortgage (REM) – the conveyance of a real estate as security for the payment of a loan and conditioned to become void upon such payment. It is essential that the mortgagor be the absolute owner of the property being mortgaged

Unacceptable

1. Properties in underdeveloped subdivisions
2. Properties in depressed area
3. Properties occupied by squatters
4. Properties for government appropriations
5. Properties with no right of way
6. Churches, Funeral Homes, Cemeteries, Memorial Parks, Schools, Hospitals and the likes
7. Properties with involuntary restrictions such as subdivisions restrictions, Sec. 4, Rule 74, Adverse Claims, Lis Pendems
8. Properties with government restrictions such as Free Patent, Sales Patent or Homestead Patent
9. Properties subject to CARP
10. Properties with unlocated or overlapping boundaries
11. Affected by lahar or foreseen to be affected by lahar
12. Properties located along rivers that erode properties with setbacks

- Chattel Mortgage (CM) – similar to the REM, except that the subject is chattel or personal property

  Chattel Mortgage: Merchandise Inventory

  - Proof of ownership
  - Copy of the Special Power of Attorney executed by the owner
  - Chattel Mortgage contract duly registered with the Register of Deeds
  - Insurance Certificate and endorsement certificate/s in favor of the bank

  Assignment of Shares of Stock (Pledge)

  - Deed of Assignment
  - Certificate of Stocks

  Assignment of Deposit

  - Deed of Assignment
  - Waiver of Confidentiality
  - Original Certificate of Time Deposit (when applicable)

- Hold-Out on Deposits – is the transfer or setting over of deposit or of rights or interest therein from one person to another, or the act by which one person transfers to another, or causes to vest in another, his right over said deposit. It merely purports to convey the deposits as collateral in order to secure the payment of a loan. If the borrower pays the loan on maturity, the transfer becomes null and void.
- Third Party Mortgage – this is executed when the borrower is not the owner of the offered collateral

- Negative Pledge – an undertaking on the part of the borrower whereby he agrees not to mortgage, encumber, transfer or dispose of his fixed assets without the consent of the creditor, while the loan is outstanding
- Mortgage Trust Indenture – this is executed by a borrower who has a huge property and has assigned a trustee/custodian of this property. All the creditors will have to receive a Mortgage Participation Certificate (MPC) indicating the extent of the collateral portion for the corresponding loan amount of each creditor

Secondary Collateral

- Assignment of Inventory, Receivables and Proceeds of Export Letters of Credit – by assignment, the deed convey the collateral to the lender to secure indebtedness
- Joint and Several Signature (JSS) – also known as suretyship where a surety binds himself solidarily with the principal debtor. However, in this undertaking the surety does not incur liability unless and until the principal debtor is held liable. In a suretyship a creditor deals/transacts with both the principal borrower and surety. Generally, a JSS is executed when the offered primary collateral is insufficient. It is a practice to require JSS under the following rules:

  - For a sole proprietorship, if the husband is the principal borrower, the wife shall execute a JSS and vice versa or any third party other than the spouse
  - If the borrower is a corporation, the principal directors and stockholders shall execute the JSS
  - If the borrower is an association, the principal officers shall execute the JSS

- Parent Guaranty – written promise to pay for a debt in case of failure of the principal debtor. Usually, applies to multinational companies, whose mother companies are based outside the country. In case of default shall be done on the properties of the principal borrower first. The guarantor's property shall be subject to foreclosure if the total value of properties of the principal debtor is insufficient to cover the loan.
- Cross Guaranty – this exists when a person or company guarantees the loan of another and vice-versa.
- Co-maker – required for secured loans when borrower is more than 60 years old. Preferably, co-makers must be the spouse or any single and gainfully employed children who is also knowledgeable of the project. Unsecure loans granted to individual borrower shall require at least 2 co-makers.

CREDIT EVALUATION

Evaluation is the process where the account officer evaluates all credit information about the borrower and the project for financing. Prior to evaluation, the account officer must generate all the relevant documents from the prospective client. Credit evaluation is made against the credit fundamentals and specific risk asset acceptance criteria. The account officer must always be mindful of the various risks associated with the account. No one person should perform both the credit evaluation and credit investigation/collateral appraisal.

The following major factors should be considered in credit evaluation: quality of ownership, management capability, financial capability, quality of collateral and conditions.

Ownership and Management

- Conduct deep analysis of the quality, skills, integrity, and reputation of the owners and management team since superficial analysis has been a primary cause of credit problems
- In credit evaluation, character and capacity should come first. One may proceed with detailed evaluation after he is satisfied of these areas
- Refrain from establishing personal involvement with the borrower to avoid “clientism”, i.e., tendency to overemphasize the interests of the clients
- One must bear in mind that a borrower that is a “house name” is not a reason to abandon common sense and sound practice during credit evaluation
- Pertinent information on the borrower may be generated during “client calls”. It is therefore prudent to generate and record through call reports information on ownership and management during “client calls”.
- In conducting evaluation of ownership and management, the following points and/or questions should be considered:

  Quality of Ownership

  - *Political Ties* (Is shareholder political? Does he have political connections? Does he have strong political ties? Is he identified with politicians as business partners, front or alleged dummy, etc.?)
  - *Additional Equity* (Do the owners have other sources of income? Are the other businesses making money? Can they infuse more capital readily? Are owners heavily indebtedness?)
  - *Character* (What is the owners’ reputation in the business community? Any cases against them, past or present? How have they handled their other investments/business? Do they indulge in any vice like gambling, etc.)
  - *Track Record* (What is the owners’ other businesses? Any risky undertakings?)
  - *Business Commitment* (What is the commitment of owners to business being financed? Is the commitment evident – fresh funds inflow, investments to improve, upgrade or modernize operations? Are owners’ actively involved in decision or policy-making

  Management Capability

  - *Quality/Integrity* (What is management’s experience level? Are they professionals? What is the degree of professionalism, educational background and training? Has management been involved in any anomaly, fraud, etc.?)

- *Track Record* (What is the performance of the borrower during the incumbency of management? What is their previous track record with other institutions?)
- *Manpower Turnover* is turnover rate higher than normal? Can the fast turnover be managed? Is the turnover contributing to enhancement of expertise or is it otherwise?)
- *Hiring Policies* (Is it done on a professional basis or is there politics involved?)
- *Training/Coaching* (Is there a training program for all levels? Is training adequate for the needs of the institution? Are policies disseminated/discussed with the staff?)
- *Bank Checking* (Are bank checking favorable or show satisfactory dealings – current, prompt payment, etc.? Are banks willing to extend clean lines?)
- *Feedback from Servicing Units* (How is the borrower perceives in the industry? Is the borrower hard to deal with, professional conservative, etc.? Is there any rumor about the borrower? What is the general perception of management compared to its competitors?
- Other areas that may be explored to further assess management quality are:
  - *Succession policy* (Is it in place? Is it patriarchal or based on competence?)
  - *Structure of management* (Is decision-making centralized or decentralized?)
  - *Remuneration policy* (How does compensation package compare with other companies?)
  - *Management stance* (Is it aggressive or conservative?)

Financial Analysis

Financial Viability

- A careful analysis of the financial condition of the borrower is one of the vital components of credit evaluation. Generally, this analysis is conducted after all the qualitative aspects of the borrower's business have been analyzed
- Determine the past performance and financial trends to establish future financial growth and directions of the borrower. This is the reason why borrowers are required to submit financial statements.
- The financial analysis should focus on the following:
  - Profitability (efficiency of operation)
  - Current position (liquidity of assets)
  - Capital position
- The financial ratios should not be analyzed in isolation. One should look at the historical trends (ratio trend analysis) and at the relations of the ratios to the industry average (cross-sectional analysis).
- One must bear in mind that ratios are mere indicators of performance. Of more importance are the factors or reasons that gave rise to these indicators. Ratios are simply the end-results of actions or a series of actions taken by the client that could be critical inputs to credit analysis.

Industry Analysis

Industry Prospects

- Analyze the general industry outlook and determine its impact on the account
- The quality of industry analysis depends highly on accuracy, timeliness and completeness of data gathered.
- Take note of any developments in the industry, including but not limited to the following:
  - Industry condition – the inherent risk in the industry, its importance to the economy and the general outlook of the industry shall be considered in the evaluation of the credit risk
  - Competition and market – the market share of the company, its rank with the industry and its competitive position
  - Supply and demand
  - Tariffs and other regulatory policies affecting the industry

Quality of Collaterals

- Be prudent in considering collaterals as possible source of repayment. Although generally considered as second way-out, their purpose as alternative sources of repayment for loans should never be overlooked during credit evaluation
- In the evaluation of the offered collateral, focus on the:
  - Reasonableness of the valuation
  - Marketability of the asset
  - Realizability of the asset values

Conditions

- Assess how the borrower anticipates and reacts to these factors:
  - General economic and political condition
  - Government decrees
  - Developments in the financial market
  - Competitive conditions
  - Industry trends/forecasts
- Economic and political conditions in the country should be considered in the evaluation of credit. Conditions within a specific industry also have a bearing on credit analysis especially if these conditions coincide with the general economic and political climate in the country
- Analyze the general industry outlook and determine its impact on the account

FIMA 30063 - CREDIT AND COLLECTION

By: Bernadette M. Panibio

Week 10–12 CREDIT AND COLLECTION PROCEDURE

- Loan Packaging
- Loan Approval
- Loan Documentation and Disbursement
- Loan Administration

At the end of the lesson, the student is expected to:

- Identify the factors that must be considered in structuring the terms and conditions of a credit transaction
- Discuss the items included in loan negotiation such as the tenor, repayment, covenants and security
- Recognize the importance of documentation in credit transactions
- Identify basic documents used in credit transactions
- Recognize the importance of account monitoring and review
- Discuss the credit support and control systems and other practices necessary to manage outstanding loans

LOAN PACKAGING AND APPROVAL

- In structuring the terms and conditions of a credit transaction, the following should be considered:
  - Fund matching principle must be observed. Short-term facilities shall be proposed for short-term credit requirements while term facility shall be considered for medium or long-term requirements
  - The terms and conditions should be flexible and responsive to the specific situation of the client, the changes in the particular industry/sector of the client, changing economic environment, and the market trends in the financing industry
  - Common sense and good judgment is a must in structuring a credit package. Credit decision cannot be based entirely on a static set of credit guidelines or analytical technique. A proactive stance is thus a must.
  - The structure of a credit package, including the terms and conditions should be clearly stated.
  - The repayment mode and tenor shall be structured based on the purpose of credit being applied for
  - All the deviations from the standard terms and conditions shall be highlighted and justified in the proposal
  - Every proposal shall have the following documents/reports:
    - Credit Proposal Executive Summary (contains the highlights of the proposal such as: information on the client/applicant, the project description, the type, amount, major terms and conditions, recommendation and justification)
    - Credit Proposal (contains the detailed information on the: applicant, the project, the results of evaluation of the financial performance/historical financial statements, projected financial statements, results of credit investigation, marketing aspects on the project, plans and prospects)
    - Basic Business Information (contains a brief background on the applicant, the project, the products and services, the market and the affiliates)
    - Credit Investigation Report (the results of the credit investigation conducted)
    - Appraisal Report (covers the results of the appraisal conducted on the collaterals offered)
    - Types and valuation of collaterals
  - Ensure that every credit extension is supported by the required approvals that shall be properly documented
  - The client should be informed of the approval of his application. The advice shall clearly state the following information:
    - Type of facility
    - Amount approved
    - Basic terms and conditions
    - Other pre-release conditions
  - Should the account be denied, a denial/disapproval notice shall likewise be sent

CREDIT DOCUMENTATION, AVAILMENTS AND DISBURSEMENTS

- All necessary legal documents prior to the initial release/restructuring or availment should be secured
- Account officers should serve as witness to the signing of all legal documents and should verify the signatures of borrowers to ascertain authenticity. Names of all signatories should be printed.
- Specimen signatures of all signatories should be maintained and updated
- Standard loan and collateral documents should be used as evidences of indebtedness or to provide support to credit extensions

<u>Credit Documentation</u>

Principal Credit/Lending Documents

1. Loan/Line Agreement – Contract between the lender and the client covering the grant of loan by the former to the latter under certain terms and conditions. Generally, it stipulates the loan type and purpose, amount, interest rate, penalties and charges, manner of repayment, availment, events of default, representations, warranties, covenants, and other stipulations or provisions not generally covered by the Promissory Note or collateral document securing the obligation.
2. Receivables Financing/Discounting Line/Agreement – Core document covering the terms and conditions whereby the proceeds of the credit facility are to be used for financing receivables.
3. Restructuring Agreement – This is used to document new terms and conditions affecting loan transactions in instances where borrower fails to meet his maturing obligations and/or by way of payment arrangement.

Availment Documents

1. Promissory Note – An unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer. It is a principal evidence of indebtedness and is to be considered along with the loan/line agreement.
2. Disclosure Statement – A document disclosing to the client the details of the loans to be released.

Collateral/Security Documents

1. Real Estate Mortgage (REM) – A contract by which a client or third party mortgagor secures in favor of the lender the fulfillment of principal obligation subjecting as security immovable (real) properties or real rights over them in the event the principal obligation is not fulfilled at the time stipulated.

2. Mortgage Trust Indenture (MTI) – A type of mortgage given to a trustee for the purpose of securing numerous creditors
3. Chattel Mortgage (CM) – Similar to REM except that the subject is chattel or personal property
4. Assignment of Receivables – A bilateral contract whereby one person transmits to another his rights, title, interests and actions against a third person either by way of payment or as a security.
5. Joint and Several Signatures (JSS)/Comprehensive Surety Agreement - Binds the key officers and management solidarily or severally with the principal borrower making them liable in case of default/non-payment due to misappropriation, fraud, mismanagement, etc.

❖ The collateral or security documents are executed to accompany loan agreements. These are, in effect, accessory contracts that cannot exist or stand along without the principal lending documents.

MANNER OF AVAILMENT

❖ Release or availment should be in accordance with the approved terms and conditions and subject to completion of all necessary and appropriate legal documents
❖ Prior to the release or availment, the following conditions should be met:

  - All pre-release requirements and conditions have been complied with and proper legal documentation has been completed including the registration of mortgage documents with appropriate registrars.
  - The credit line has not expired or has not been exceeded
  - Borrower has no past due availment
  - Amount to be released will not exceed the approved credit limit or in accordance with the approved schedule of releases
  - All availment documents have been signed by the borrower, and signed by the account officer as witness and other documents duly authenticated
  - All PNs with Deed of Assignment should be accomplished and execute by the borrower and signed by the account officer as witness

❖ Releases should pass through different authorized signatories. No one person or division can singularly approve or effect a release
❖ Releases may be made in the following manner:

  - One-time/lump sum release
  - Partial release

RECEIPT AND MAINTENANCE OF CREDIT DOCUMENTS

❖ All original documents related to each availment should be reviewed and maintained.

- ❖ Exceptions, deviations or deferrals from standard terms and conditions should be subject to approval

RELEASE OF COLLATERALS AND PREPARATION OF DOCUMENTS RELATED THERETO

- ❖ Cancellation of mortgages and release of collateral are allowed upon full payment of the loan, including other attendant obligation such as insurance, real estate taxes, etc.
- ❖ Release of mortgages, guarantees, and other documents after the full payment of the loan should be consistent with the provisions

ACCOUNT MONITORING AND CREDIT ADMINISTRATION

Account monitoring and credit administration refers to proper provision of credit support, control systems and other practices necessary to manage outstanding risk assets. Timely repayment of obligation by a client is an indicator or good credit administration.

- ❖ All outstanding credit obligations should be monitored closely to ensure prompt payment at the prescribed due date of the loan, interest and any other charges or expenses associated with the transaction
- ❖ Past due obligations should be promptly handled. Remedial action should be promptly instituted to keep the account in current status.
- ❖ All credit facilities must be monitored periodically to ensure compliance with key covenants, repayment schedule, and other terms and conditions governing the facility. Client calls should be conducted and results documented through call reports. Information necessary to properly evaluate the status of the client should be captured in the call reports
- ❖ Industry and market developments should be regularly monitored and the impact of any development in the industry on the credit account should be evaluated. If the industry development signals a potential problem, a client call to discuss the issue with the borrower should be conducted as soon as possible.
- ❖ Borrowers with outstanding credit facilities or availments should submit the documents that are required on a periodic basis, as stipulated in the loan agreement.

Major Areas of Account Monitoring

1. Compliance to Terms and Conditions – Availments under the approved credit facilities should conform to the terms and conditions stipulated in the approved credit proposal.
2. Collection of Loan Amortization

    a) Prompt Payment of Accounts – All outstanding loans must be monitored closely to ensure prompt payment at maturity of the amortization and any other charges or expenses associated with the transaction
    b) Collection of Past Due Obligations – Past due obligations for collection should be properly handled. Remedial actions should be promptly instituted for keep the account in current status

c) Compliance with Key Covenants – Loans must be monitored periodically to ensure compliance with key covenants, repayment schedule, and other terms and conditions governing the loan
d) Periodic Submission of Requirements – Borrowers with outstanding credit facilities should submit the documents that are required on a period basis as stipulated in the loan agreement.
e) Monitoring of Industry Situation – Industry and market developments should be regularly monitored and the impact of any development in the industry on the loan account be evaluated. If the industry development signals a potential problem, a client call to discuss the issue with the borrower should be conducted as soon as possible.
f) Appraisal/Inspection of Collateral – Periodic inspection and appraisal of supporting collaterals must e done to validate the conditions/existence and adequacy of collateral vis-à-vis the outstanding risk

Credit File Maintenance

Credit files refer to all the documents that are related to the account. These shall include, but not limited to records of past experience with the client, the financial statement furnished by the borrower, the credit proposal, financial projections, business background information, CIR, appraisal report, inspection report, business registration and other permits, real estate tax receipts.

- A credit folder must be set up and maintained for each borrower for the immediate reference and guide
- All photocopied documents submitted by the client should be stamped “certified true copy” upon presentation of the original copy and authenticated by the account officer
- Photocopied documents including the amendments thereto sourced from the government agency/s or office/s must be authenticated by the authorized officer from the source government agency/s or office/s
- The credit file provides credit officers a convenient reference about the basic information on the subject, and a history of the credit relationship with the borrower
- Credit folders must be treated as confidential and only authorized personnel may have access to these files
- The documents in the credit folders must be reviewed and maintained in good order

Week 13 – 15 Collections and Repayments
Remedial Accounts Management
Credit Review

At the end of the lesson, the student is expected to:

- Discuss the tools and aids in collecting
- Describe the strategies and tactics of collection
- Discuss remedial accounts procedure
- Recognize situations for possible work-out

Collection Program – strategies, organization and procedures for recovery of receivables

The company may consider various collection strategies: should it subcontract collections through a collection agency or should collections be done in-house? As a policy, should it employ "high pressure" collection tactics or the more indirect approaches? The choice for collections may range from the use of salesmen to double-up as collectors to a separate decentralized collection unit responsible only for that function. Finally, procedures involve the keeping of records, billing, conducting follow-up phone calls or personal client visits and undertaking legal actions.

The objectives of a collection program are:

a) To reduce the amount of bad debt losses while controlling collection costs
b) To reduce the company's investment in accounts receivable

Collection Policy

Collection Department – responsible for monitoring and following up on receivables

The credit manager should determine the reasons why accounts become overdue and delinquent and then the customers so that proper measures can be initiated.

Customers may be classified into the following:

- Customers who honestly misunderstood the terms of sale
- Customers who overlook their accounts
- Customers who disregard due dates
- Customers who tend to stretch their payables
- Customers who usually pay but are temporarily illiquid
- Customers who are deliberately delinquent
- Customers who are insolvent

Stages of Collection

1. Preliminary stage- usually involves the sending of monthly statements
2. Reminder stage – reminder is sent to customer several days after due date
3. Follow-up stage – where successive action are undertaken at regularly spaced interval
4. Drastic stage – this stage is only resorted to if the company is ready to lose the customer (collection is through an attorney or collection agency)

PROBLEM ACCOUNTS AND REMEDIAL ACCOUNT MANAGEMENT

Generally, lending problems may be caused by lapses in loan packaging and/or customer and related factors. The specific causes of these factors may be as follows:

Loan Packaging

- Neglect of basic criteria and standards
- Excessive emphasis on project earnings and setting aside the capability of client to run the project
- Unclear/unspecific loan purpose thereby allowing disbursements not related to the project
- Source of repayment is not tangible and quantifiable
- Weak second way out
- Inappropriate amortization schedule
- Giving in to competitive pressures resulting to soft credit terms/conditions and sacrificing standards

Customer-Related Factors

- Dominance by one or few officers of business/project operations
- Dependence on one product line resulting to inflexibility to changes in the market
- Inability of management to cope with changes in the industry
- Short-term borrowings used for the acquisition of fixed assets and/or non-earning projects
- Inappropriate timing of projects and inadequate financial planning
- Lack of professionalism of officers and management

Related Factors

- Failure to detect early warning signals
- Inadequate loan agreement provisions and/or other terms and conditions
- Unrealistic high targets on loan releases resulting to deviation from credit standards
- Neglect of basic credit criteria
- Lapses in loan implementation/non-compliance to approved terms and conditions

Account Officers should always take note of the symptoms of weakened accounts since their early recognition is critical to the formulation of appropriate courses of action. The following are the early warning signals of weakened accounts:

Violation of Loan Agreement Provisions

- Diversion of funds/loan proceeds
- Lapses in installment payments
- Waiver or violation of safeguards against defaults
- Unremitted collection

Internal Problems

- Failure to submit financial statements on time
- Management shake-up
- Emergency/unscheduled BOD reorganization/meetings
- Willful default among members
- Disappearance of officers/assets
- Marked difference between projections and actual operations
- Returned checks to suppliers and creditors
- Failure to submit financial statements on time

Financial

- Low sales turnover
- Diminishing margin of profitability
- Decline in inventory turn-over
- Build-up of receivables vs. sales/total assets
- Increase in liabilities
- Decline in net worth
- Competitive operations
- Deteriorating cash position
- Increasing collection period
- Rise in inventory costs as a percentage of total assets without justifiable reasons
- Marked decline in current assets as a percentage of total assets
- Increasing bad debts
- Rising sales, falling profits
- Rising operating expenses as a percentage of sales/revenue

Non-financial Indicators

- Unreasonable request for substantial increase in credit
- Investment in non-related ventures of business
- Fast turn-over of employees without justifiable reasons
- Problems or squabble among and between stockholders or owners
- Flurry of insolvencies or bankruptcies in the field of business or area of operation of the debtor or customer
- Habitual issuances of bouncing checks
- Buying at big volumes and selling at cost or at a loss
- Substantial or repeated rumors about the unsatisfactory credit habits of the debtor
- Sudden unexplainable decrease in manpower
- Poor appearance of the office or place of business
- Dishonesty of officers or employees of the debtor
- New laws adversely affecting a debtor's business
- Insufficiency or lack of insurance coverage

Remedial Account Management

- The art of preventing the occurrence of, and bringing about prompt and satisfactory conclusion to problem account situations

Problem Account

- One in which there is a major breakdown in the repayment agreement resulting in an undue delay in collection, or in which it appears legal action may be required to effect collection, or in which there appears to be a potential loss

Objectives of Remedial Account Management

1. To nurse a substandard or doubtful account back to health

    - A firm or bank sometimes does absorb such accounts, maybe due to faulty credit processing and evaluation, or due to the exigencies of the business, e.g., the firm must sell its goods which are about to become obsolete or the bank has excessive loanable fund, or that because of business reverses, management or even acts of God, the debtor has subsequently become a substandard or doubtful risk

2. To regularize credit and document deficiencies

    - Hurried credit decisions sometimes had to be made, or for some reason or the other. There is, therefore, the need to gather more credit information on the debtor in order to find out exactly his credit worthiness – and credit rating. Should he turn out to be doubtful or substandard risk, then remedial measures must have to be applied to save the account from turning into bad debt. Or sometimes, due to oversight or haste, the supporting documents of loan or credit extension are defective or deficient or even absent.

3. To strengthen weaknesses of the credit extension by way of additional collateral, security or guaranty

4. To locate missing customers (skip tracing)

    - One principal headache of collection is tracing the missing customer. A customer may be missing intentionally or unintentionally. If the disappearance is intentional to defraud creditors, then the task becomes doubly difficult. Sometimes, though, a customer is missing, not intentionally but because of transfer of residence or office.

5. To anticipate debtor's defenses

Requisites for Effective Remedial Management

1. Specific unit to handle problem account
    - Organizational structure
    - Defined responsibility
    - Adequate authority
2. Adequate manpower
    - Qualifications
    - Selection
    - Training and development
3. Policies, systems and procedure
    - Criteria for account take-over
    - Process management guidelines

Remedial Process

1. Account Review
    - Determine weaknesses (financials, documentation, collaterals)
    - Determine cause of problem (consult, categorize client)
2. Capability Analysis
    - Evaluate alternatives available
    - Your strengths and weaknesses
    - Possible support (internal, external)
3. Strategy Formulation
    - What ought to be done
    - How to achieve it
    - Approvals/time frame
    - Commitment/determination to achieve what ought to be done
4. Strategy Implementation
    - Monitoring
    - Revision/s
    - Timing

- Record arrangements
- Reports

Remedial Measures

Strategies and activities that compromise an overall rehabilitation plan to help the client meet its maturing obligations and improve lender's chances of recovery. The remedial measures may include the following:

1. Loan Restructuring – Any change in the principal terms and conditions of the loan in accordance with a restructuring agreement setting forth a new plan of payment on a periodic basis. The following are circumstances that warrant restructuring:

   - Admission by the borrower than can no longer comply with the present amortization schedule due to business reverses
   - Occurrence of unfavorable events that are beyond the control of the borrower and which will greatly impair the cash flow or liquidity of the project like natural calamities, fire, labor and management problems

     - ❖ Loan restructuring should be done only if the borrower still has the capacity to pay his obligations and needs a set of new repayment terms. The sources of repayment must be validated and the results of which must be included in the restructuring proposal

2. Compromise Settlement – Covers lump sum payment either through cash payment and generally includes penalty changes
3. Off-setting/Linkage – Involves the provision by the borrower of services and/or goods as loan settlement. The good/services shall be used to liquidate the borrower's obligation
4. Strengthen Collateral Credit Position – Involves the securing of additional collateral to secure the loan and/or continuing Guaranty and/or JSS by a more viable and/or acceptable party as further security of the loan
5. Assumption of Mortgage – Involves the assumption of mortgage by a third party, e.g. a private individual, partnership, company, etc. wherein he assumes the obligation of the borrower
6. Foreclosure – Procedure by which mortgaged property is sold upon default of a mortgage in satisfaction of mortgage debt

CREDIT REVIEW

Credit Review is an integral part of a total system for managing the credit portfolio. The overriding concern is to help develop correct credit practices and procedures to minimize credit risks. The following are the primary goals of credit review:

- Assess the management of credit risks
- Identify areas in the credit operation that need improvement and recommend corrective action

- Instill awareness adherence to credit standards and practices
- Provide inputs for credit policy formulation
- Provide feedback on the overall credit risk assessment

Scope of Credit Review

1. The credit review focus on the assessment of two major credit aspects. The major credit standards to properly evaluate credit practices are as follows:

    3.1. Portfolio Quality – This is principally evaluated using a quantitative assessment of the portfolio mix and past due rate

    3.1. Process Quality – Is an assessment of the procedures in the marketing and administration of accounts based on established credit policies and procedures. The process is also categorized into the following:

        1.1. Target Market – The review determines if the account solicitation activities are systematically undertaken considering the prescribed target market
        1.2. Credit Initiation and Analysis – The review will focus on the quality of evaluation and analysis of credit risks that results in the extension of credit
        1.3. Loan Documentation and Disbursement – This involves the verification of the appropriateness, adequacy and completeness of loan documentation, as well as compliance to all pre-release conditions of loan and collateral documentary requirements. The review sees to it that all availments, renewals, extension and other credit-related transactions are properly approved
        1.4. Credit Administration and Documents Management – The review validates the effectiveness of the credit monitoring and supervision and support system
        1.5. Problem Recognition – The review assesses the ability to anticipate adverse factors affecting credit risk and detects potential problem accounts, as well as timely reporting of such events to the p roper authorities

2. Organization and Staffing

    2.1. Organization and Deployment – This aspect of the review establishes the appropriateness of the organizational set-up in terms of staff adequacy, work experience, delineation of functions, account assignment, among others

    2.2. Coaching and Training – The review determines the availability and effectiveness of training programs and other coaching tools in the delivery of functions

3. On loan recovery, the review focuses on two major aspects, as follows:

    3.1. Remedial Management – This generally shows the action plan as well as results of recovery measures on distressed accounts. Assessment of this block includes the evaluation of work-out plans, actions on vital documentary deficiencies, tracking of remedial actions and actual results of recovery programs and actions.

Normal Management – This is an evaluation of the processes in the administration of problem accounts. The review deals basically on the credit monitoring and supervision activities, anticipation and recognition of problem

EXAMPLE OF SPECIFIC CREDIT POLICIES

A. Loan Values

The maximum commercial loan amount shall not exceed the following loan values:

Security/Support	**Loan Value**
1. Loans secured by Real Estate	• 60% of the appraised value of the property
2. Loans secured by Chattel covered by Insurance	• 50% of the appraised value of the chattel
3. Loans secured by Shares of Stock	• 50% of the market value of the shares during times of steady share prices. This may be further reduced during times of significantly bull or bear markets.
4. Loans against Assignment of Proceeds of Export Shipment	• 50% to 80% of the amount of the assigned valid export LCs or shipment. The maximum 80% loan value applies only for those accounts with proven track records and reliability in effecting shipments.
5. Loans against assignment of contracts, P.O.s, receivables, etc. from reputable firms	• 50% to 80% of the value of the contracts, P.O.s or receivables
6. Loans against deposits (savings, time deposit, etc.) or back-to-back loans <u>in the same currency</u>	• Up to the deposit balance sufficient to cover the loan principal provided that interest is paid monthly. Otherwise, the collateral should cover both principal and interest.
7. Loans against deposits (savings, time deposit, etc.) or back-to-back loans in different currencies	• Up to 80% of the deposit balance sufficient to cover the loan principal and interest.

Loans approved as exceptions and in excess of the above-mentioned loan values for real estate, shares of stock, and deposits shall be treated as partially secured accommodations and subject to the requirements of a co-maker/guarantor.

B. Policies on Loans Against Real Estate

1. The real estate mortgage should be registered prior to the release of any loan proceeds to prevent any third party from acquiring a lien ahead of the Bank.

2. If there are improvements existing on the property, these improvements should be insured and the insurance policy together with the official receipt of premium payment lodged with and endorsed to the Bank.

3. Real estate property owned by a corporation may not be used as security for the loan of another party unless it is determined that its Articles of Incorporation indicate that the corporation can guarantee a third party obligation and use its properties to guarantee such obligation. Otherwise, a stockholders' resolution is required to validate the use of the corporation's property as collateral securing another party's obligation.

4. Real estate developers who sue their inventory of properties as collateral support for loans granted by the Bank, must execute at the inception of the loan and upon execution of the mortgage a certification under oath that none of the properties mortgaged to the Bank have been sold (regardless whether it was sold on a cash or contract-to-sell basis). Afterward, it is incumbent upon the real estate developer to submit regular updates to the Bank informing it of what units have been sold and henceforth excluded from the original certification. Without these formal updates, all units described in the original certification are understood to remain unsold.

C. Policies on Loans Against Chattel Mortgage

1. The chattel mortgage should be registered with the Register of Deeds in the place where the chattels are located and also at the principal place of business or address of the mortgagor if that address is not the same as where the chattels are located. For motor vehicles and motor vessels, the chattel mortgage should also be registered with the Land Transportation Office (LTO) and Maritime Industry Authority (MARINA) respectively.

2. The chattels should be insured for its appraised value and the duly endorsed insurance policy and official receipt of premium payments submitted to the Bank.

3. Where applicable, an identifying label should be attached to chattels indicating that these are mortgaged to the Bank.

4. Machinery and equipment should be appraised yearly, while inventory should be appraised semi-annually.

D. Policy on Second Mortgage

Normally a second mortgage is not acceptable security to justify an initial credit relationship. The bank may consider a second mortgage as a form of security only to improve an existing credit exposure and only after it has been ascertained that the loan secured by the first mortgage may be prepaid as a matter of right and provided, that the loan value of the property subject of second mortgage is sufficient to cover both loans. Correspondingly, careful scrutiny of the loan documents relating to the first mortgage and appraisal must be conducted to determine if there is still enough loan value to cover both loans.

The Borrower shall agree in writing that the Bank may at any time prepay the loan secured by the first mortgage or the right of prepayment shall be assigned and transferred to the Bank as one of the conditions for the grant of the loan.

Loans granted against second mortgages are deemed to be clean accommodations, and shall be recorded as such in the books of the Bank.

E. Foreign Currency Loans

Foreign currency loans shall only be granted to Borrowers who have sources of revenue in the same foreign currency. This way, only Borrowers who have the ability to hedge foreign currency risk exposure are granted foreign currency loans. Consequently, the Bank expects that these Borrowers will be in a better position and will have less difficulty in servicing their loans.

Loans that are secured by foreign currency deposits (or foreign currency loans secured by Peso deposits), the loan value of the deposit securing the loan is pegged at 80% of the prevailing base rate at the time of the drawdown. The scaling down of the prevailing base rate is necessary to account for the volatility of the foreign currency exchange rate. Any amount in excess of the prescribed 80% loan value shall be considered clean.

F. Policy on Marital Conformity

Express marital consent or conformity is a must in all contracts requiring such.

Under both the regimes of Conjugal Partnership of Gains (covering marriages celebration prior to August 3, 1988) and Absolute Community of Property (covering marriages celebrated on or after August 3, 1988), the administration of conjugal/community property belongs to both spouses jointly. As such:

1. All debts and obligations contracted during the marriage must be consented to by both spouses in order that the conjugal/community property may be held liable for the same.

2. Similarly, a suretyship executed only by one spouse can only hold the conjugal/community property liable to the extent that the family may have been benefited from the debt of the principal Borrower.

3. Acts of ownership, such as sale, disposition, mortgage, or encumbrance of the community property, require the written consent of the other spouse or authority from the court. Otherwise, the disposition or encumbrance is void, and is merely construed as a continuing offer to be perfected by the other spouse before either party withdraws the offer to the contract.

Given the legal considerations and consequent risks, the Bank is in a drastically inferior position if marital conformity is not secured in the above-mentioned transactions. As such, any request for waiver of marital consent should be based on justifications thoroughly discussed in the credit manual. Furthermore, the approving body should be convinced of the following:

1. Strength of the financial conditions of the business operations of the Borrower as a source of repayment; and

2. The exclusive property of the Borrower/Surety provides sufficient source of payment for the Bank's exposure.

In no case shall waiver of marital conformity for the sale, disposition, mortgage or encumbrance of conjugal/community property be allowed.

I. Policies Covering Back-to-Back Loans

As back-to-back loans (loans vs. 100% cash deposits or cash LCs) represent minimal risk (and are excluded in determining the total aggregate exposure to a Borrower/group).

As a matter of policy, back-to-back loan documents and collateral should be endorsed to lending institutions for safekeeping.

J. Policies on Trade Check Discounting

1. The term of the loan should not exceed the usual credit terms extended by the Borrower to its Clients.

2. Interest on loan should be collected in advance to insure full settlement upon maturity.

3. Checks cleared before maturity of the promissory note are not entitled to rebates.

4. Checks eligible for discounting:

a) Postdated checks representing payments for goods and services already delivered and accepted in the normal course of business.

b) Checks clearable through the Philippine Clearing House Corporation, local clearing facilities and BSP regional clearing office.

c) Borrower is the Payee or first endorser of the check.

d) The check is properly issued and free from any defect that would prevent negotiation through the normal clearing process.

5. Checks ineligible for discounting:

   a) Personal checks on individual Borrower including checks of the owner/major stockholder/officer/signatory of the business entity, postdated checks covering receivables from subsidiary/affiliates/related firms of the Borrower.

   b) Postdated checks issued by a Drawer with a history of issuing unfounded checks.
   c) Postdated checks drawn against out-of-town banks where there is no BSP regional clearing office.

6. In case postdated checks are drawn on another UCPB branch, and the branch has been advised that checks have been discounted, it is incumbent on them to advise the booking branch immediately if the account is closed or a stop payment instruction has been given on the discounted checks.

7. If the name of the drawer of the postdated check accepted is not printed on the check, it is incumbent upon the Account Officer/Branch Head to properly confirm its identity.

8. A Credit/Letter Agreement shall cover trade check discounting lines and each availment shall be documented via a promissory note with deed of assignment.

9. All assigned checks should be credited to the corresponding PN and presented for clearing on the date of each check until the PN is fully paid.

FIMA 30063 - CREDIT AND COLLECTION

By: Bernadette M. Panibio

Week 16 – 17 Legal Aspects of Credit and Collection

At the end of the lesson, the student is expected to:

- Identify pertinent laws on loans
- Recognize situations needing legal actions

REPUBLIC ACT No. 3765

AN ACT TO REQUIRE THE DISCLOSURE OF FINANCE CHARGES IN CONNECTION WITH EXTENSIONS OF CREDIT.

Section 1. This Act shall be known as the "Truth in Lending Act."

Section 2. Declaration of Policy.
It is hereby declared to be the policy of the State to protect its citizens from a lack of awareness of the true cost of credit to the user by assuring a full disclosure of such cost with a view of preventing the uninformed use of credit to the detriment of the national economy.

Section 3. As used in this Act, the term

(1) "Board" means the Monetary Board of the Central Bank of the Philippines.

(2) "Credit" means any loan, mortgage, deed of trust, advance, or discount; any conditional sales contract; any contract to sell, or sale or contract of sale of property or services, either for present or future delivery, under which part or all of the price is payable subsequent to the making of such sale or contract; any rental-purchase contract; any contract or arrangement for the hire, bailment, or leasing of property; any option, demand, lien, pledge, or other claim against, or for the delivery of, property or money; any purchase, or other acquisition of, or any credit upon the security of, any obligation of claim arising out of any of the foregoing; and any transaction or series of transactions having a similar purpose or effect.

(3) "Finance charge" includes interest, fees, service charges, discounts, and such other charges incident to the extension of credit as the Board may be regulation prescribe.

(4) "Creditor" means any person engaged in the business of extending credit (including any person who as a regular business practice make loans or sells or rents property or services on a time, credit, or installment basis, either as principal or as agent) who requires as an incident to the extension of credit, the payment of a finance charge.

(5) "Person" means any individual, corporation, partnership, association, or other organized group of persons, or the legal successor or representative of the foregoing, and includes the Philippine Government or any agency thereof, or any other government, or of any of its political subdivisions, or any agency of the foregoing.

Section 4. Any creditor shall furnish to each person to whom credit is extended, prior to the consummation of the transaction, a clear statement in writing setting forth, to the extent applicable and in accordance with rules and regulations prescribed by the Board, the following information:

(1) the cash price or delivered price of the property or service to be acquired;
(2) the amounts, if any, to be credited as down payment and/or trade-in;
(3) the difference between the amounts set forth under clauses (1) and (2);
(4) the charges, individually itemized, which are paid or to be paid by such person in connection with the transaction but which are not incident to the extension of credit;
(5) the total amount to be financed;
(6) the finance charge expressed in terms of pesos and centavos; and
(7) the percentage that the finance bears to the total amount to be financed expressed as a simple annual rate on the outstanding unpaid balance of the obligation.

Section 5. The Board shall prescribe such rules and regulations as may be necessary or proper in carrying out the provisions of this Act. Any rule or regulation prescribed hereunder may contain such classifications and differentiations as in the judgment of the Board are necessary or proper to effectuate the purposes of this Act or to prevent circumvention or evasion, or to facilitate the enforcement of this Act, or any rule or regulation issued thereunder.

Section 6.
(a) Any creditor who in connection with any credit transaction fails to disclose to any person any information in violation of this Act or any regulation issued thereunder shall be liable to such person in the amount of P100 or in an amount equal to twice the finance charged required by such creditor in connection with such transaction, whichever is the greater, except that such liability shall not exceed P2,000 on any credit transaction. Action to recover such penalty may be brought by such person within one year from the date of the occurrence of the violation, in any court of competent jurisdiction. In any action under this subsection in which any person is entitled to a recovery, the creditor shall be liable for reasonable attorney's fees and court costs as determined by the court.
(b) Except as specified in subsection (a) of this section, nothing contained in this Act or any regulation contained in this Act or any regulation thereunder shall affect the validity or enforceability of any contract or transactions.
(c) Any person who willfully violates any provision of this Act or any regulation issued thereunder shall be fined by not less than P1,00 or more than P5,000 or imprisonment for not less than 6 months, nor more than one year or both.
(d) No punishment or penalty provided by this Act shall apply to the Philippine Government or any agency or any political subdivision thereof.
(e) A final judgment hereafter rendered in any criminal proceeding under this Act to the effect that a defendant has willfully violated this Act shall be prima facie evidence against such defendant in an action or proceeding brought by any other party against such defendant under this Act as to all matters respecting which said judgment would be an estoppel as between the parties thereto.

Section 7. This Act shall become effective upon approval.

Approved: June 22, 1963

BATAS PAMBANSA BLG. 22
AN ACT PENALIZING THE MAKING OR DRAWING AND ISSUANCE OF A CHECK WITHOUT SUFFICIENT FUNDS OR CREDIT AND FOR OTHER PURPOSES.

Section 1. *Checks without sufficient funds.* –

Any person who makes or draws and issues any check to apply on account or for value, knowing at the time of issue that he does not have sufficient funds in or credit with the drawee bank for the payment of such check in full upon its presentment, which check is subsequently dishonored by the drawee bank for insufficiency of funds or credit or would have been dishonored for the same reason had not the drawer, without any valid reason, ordered the bank to stop payment, shall be punished by imprisonment of not less than thirty days but not more than one (1) year or by a fine of not less than but not more than double the amount of the check which fine shall in no case exceed Two Hundred Thousand Pesos, or both such fine and imprisonment at the discretion of the court.

The same penalty shall be imposed upon any person who, having sufficient funds in or credit with the drawee bank when he makes or draws and issues a check, shall fail to keep sufficient funds or to maintain a credit to cover the full amount of the check if presented within a period of ninety (90) days from the date appearing thereon, for which reason it is dishonored by the drawee bank.

Where the check is drawn by a corporation, company or entity, the person or persons who actually signed the check in behalf of such drawer shall be liable under this Act.

Sec. 2. *Evidence of knowledge of insufficient funds.* –

The making, drawing and issuance of a check payment of which is refused by the drawee because of insufficient funds in or credit with such bank, when presented within ninety (90) days from the date of the check, shall be prima facie evidence of knowledge of such insufficiency of funds or credit unless such maker or drawer pays the holder thereof the amount due thereon, or makes arrangements for payment in full by the drawee of such check within (5) banking days after receiving notice that such check has not been paid by the drawee.

Sec. 3. *Duty of drawee; rules of evidence.* –

It shall be the duty of the drawee of any check, when refusing to pay the same to the holder thereof upon presentment, to cause to be written, printed, or stamped in plain language thereon, or attached thereto, the reason for drawee's dishonor or refusal to pay the same: *Provided*, That where there are no sufficient funds in or credit with such drawee bank, such fact shall always be explicitly stated in the notice of dishonor or refusal. In all prosecutions under this Act, the introduction in evidence of any unpaid and dishonored check, having the drawee's refusal to pay stamped or written thereon or attached thereto, with the reason therefor as aforesaid, shall be prima facie evidence of the making or issuance of said check, and the due presentment to the drawee for payment and the dishonor thereof, and that the same was properly dishonored for the reason written, stamped or attached by the drawee on such dishonored check.

Notwithstanding receipt of an order to stop payment, the drawee shall state in the notice that there were no sufficient funds in or credit with such bank for the payment in full of such check, if such be the fact.

Sec. 4. *Credit construed.* –

The word *"credit"* as used herein shall be construed to mean an arrangement or understanding with the bank for the payment of such check.

Sec. 5. *Liability under the Revised Penal Code*. –

Prosecution under this Act shall be without prejudice to any liability for violation of any provision of the Revised Penal Code.

Sec. 6. *Separability clause.* –

If any separable provision of this Act be declared unconstitutional, the remaining provisions shall continue to be in force.

Sec. 7. *Effectivity*. –
This Act shall take effect fifteen days after publication in the Official Gazette.

REPUBLIC ACT No. 9510

AN ACT ESTABLISHING THE CREDIT INFORMATION SYSTEM AND FOR OTHER PURPOSES

Be it enacted by the Senate and House of Representatives of the Philippines in Congress assembled:

Section 1. *Title*. - This Act shall be known as the **"*Credit Information System Act*".**

Section 2. *Declaration of Policy*. - The State recognizes the need to establish a comprehensive and centralized credit information system for the collection and dissemination of fair and accurate information relevant to, or arising from, credit and credit-related activities of all entities participating in the financial system. A credit information system will directly address the need for reliable credit information concerning the credit standing and track record of borrowers.

The operations and services of a credit information system can be expected to: greatly improve the overall availability of credit especially to micro, small and medium-scale enterprises; provide mechanisms to make credit more cost-effective; and reduce the excessive dependence on collateral to secure credit facilities.

The State shall endeavor to have credit information provided at the least cost to all participants and shall ensure the protection of consumer rights and the existence of fair competition in the industry at all times.

An efficient credit information system will also enable financial institutions to reduce their over-all credit risk, contributing to a healthier and more stable financial system.

Section 3. *Definition of Terms*. - For purposes of this Act:

(a) "*Accessing Entity*" refers to any submitting entity or any other entity authorized by the Corporation to access basic credit data from the Corporation.

(b) "*Basic Credit Data*" refers to positive and negative information provided by a borrower to a submitting entity in connection with the application for and availment of a credit facility and any information on the borrower's creditworthiness in the possession of the submitting entity and other factual and objective information related or relevant thereto in the submitting entity's data files or that of other sources of information: *Provided*, that in the absence of a written waiver duly accomplished by the borrower, basic credit data shall exclude confidential information on bank deposits and/or clients funds under Republic Act No. 1405 (Law on Secrecy of Bank Deposits), Republic Act No. 6426 (The Foreign Currency Deposit Act), Republic Act No. 8791 (The General Banking Law of 2000), Republic Act No. 9160 (Anti-Money Laundering Law) and their amendatory laws.

(c) "*Borrower*" refers to a natural or juridical person, including any local government unit (LGU), its subsidiaries and affiliates, that applies for and/or avails of a credit facility.

(d) "*BSP*" refers to the Bangko Sentral ng Pilipinas, created under Republic Act No.7653.

(e) "*Corporation*" refers to the Credit Information Corporation established under Section 5 of this Act.

(f) "*Credit facility*" refers to any loan, credit line, guarantee or any other form of financial accommodation from a submitting entity: *Provided*, That for purposes of this Act, deposits in banks shall not be considered a credit facility extended by the depositor in favor of the bank.

(g) "*Credit Rating*" refers to an opinion regarding the creditworthiness of a borrower or of an issuer of debt security, using an established and defined ranking system.

(h) "*Credit Report*" refers to a summary of consolidated and evaluated information on creditworthiness, credit standing, credit capacity, character and general reputation of a borrower.

(i) "*Government Lending Institutions*" refers to existing and future government (GFIs), government-owned and controlled corporations (GOCCs) primarilly engaged in lending activities.

(j) "*Negative Credit Information*" refers to information/data concerning the poor credit performance of borrowers such as, but not limited to, defaults on loans, adverse court judgments relating to debts and reports on bankruptcy, insolvency, petitions or orders on suspension of payments and corporate rehabilitation.

(k) "*Non-Accessing Entity*" refers to an entity other than a Submitting Entity, Special Accessing Entity or Borrower that is authorized by the Corporation to access credit information from a Special Accessing Entity.

(l) "*Outsource entity*" refers to any accredited third party provider to whom the Corporation may outsource the processing and consolidation of basic credit data pertaining to a borrower or issuer of debt or convertible securities under such qualifications, criteria and strict confidentiality guidelines that the Corporation shall prescribe and duly publish.

(m) "*Positive credit information*" refers to information/data concerning the credit performance of a borrower such as, but not limited to, information on timely repayments or non-delinquency.

(n) "*Relevant Government Agencies*" refers to the Department of Finance, Department of Trade and Industry, Bangko Sentral ng Pilipinas, Insurance Commission and the Cooperative Development Authority.

(o) "*SEC*" refers to the Securities and Exchange Commission.

(p) "*Special Accessing Entity*" refers to a duly accredited private corporation engaged primarily in the business of providing credit reports, ratings and other similar credit information products and services.

(q) "*Submitting Entity*" refers to any entity that provides credit facilities such as, but not limited to, banks, quasi-banks, trust entities, investment houses, financing companies, cooperatives, nongovernmental, micro-financing organizations, credit card companies, insurance companies and government lending institutions.

Section 4. *Establishment of the Credit Information System*. - In furtherance of the policy set forth in Section 2 of this Act, a credit information system is hereby established.

(a) Banks, quasi-banks, their subsidiaries and affiliates, life insurance companies, credit card companies and other entities that provide credit facilities are required to submit basic credit data and updates thereon on a regular basis to the Corporation.

(b) The Corporation may include other credit providers to be subject to compulsory participation: *Provided*, That all other entities qualified to be submitting entities may participate subject to their acceptance by the Corporation: *Provided*, *further*, That, in all cases, participation under the system shall be in accordance with such standards and rules that the SEC in coordination with the relevant government agencies my prescribe.

(c) Participating submitting entities are required to submit to the Corporation any negative and positive credit information that tends to update and/or correct the credit status of borrowers. The Corporation shall fix the time interval for such submission: *Provided*, That such interval shall not be less than fifteen (15) working days but not more than thirty (30) working days.

(d) The Corporation should regularly collect basic credit data of borrowers at least on a quarterly basis to correct/update the basic credit data of said borrowers.

(e) The Corporation may also access credit and other relevant information from government offices, judicial and administrative tribunals, prosecutorial agencies and other related offices, as well as pension plans administered by the government.

(f) Each submitting entity shall notify its borrowers of the former's obligation to submit basic credit data to the Corporation and the disclosure thereof to the Corporation, subject to the provisions of this Act and the implementing rules and regulations.

(g) The Corporation is in turn authorized to release consolidated basic credit data on the borrower, subject to the provisions of Section 6 of this Act.

(h) The negative information on the borrower as contained in the credit history files of borrowers should stay in the database of the Corporation unless sooner corrected, for not more than three (3) years from and after the date when the negative credit information was rectified through payment or liquidation of the debt, or through settlement of debts through compromise agreements or court decisions that exculpate the borrower from liability. Negative information shall be corrected and updated within fifteen (15) days from the time of payment, liquidation or settlement of debts.

(i) Special Accessing Entities shall be accredited by the Corporation in accordance with such standards and rules as the SEC in coordination with the relevant government agencies, may prescribe.

(j) Special accessing entities shall be entitled access to the Corporation's pool of consolidated basic credit data, subject to the provisions of Section s 6 and 7 of this Act and related implementing rules and regulations.

(k) Special accessing entities are prohibited from releasing basic credit data received from the Corporation or credit reports and credit ratings derived from the basic credit data received from the Corporation, to non-accessing entities unless the written consent or authorization has been obtained from the Borrower: *Provided*, *however*, That in case the borrower is a local government unit (LGU) or its subsidiary or affiliate, the special accessing entity may release credit information on the LGU, its subsidiary or affiliate upon written request and payment of reasonable fees by a constituent of the concerned LGU.

(l) Outsource Entities, which may process and consolidate basic credit data, are absolutely prohibited from releasing such data received from the Corporation other than to the Corporation itself.

(m) Accessing Entities shall hold strictly confidential any credit information they receive from the Corporation.

(n) The borrower has the right to know the causes of refusal of the application for credit facilities or services from a financial institution that uses basic credit data as basis or ground for such a refusal.

(o) The borrower, for a reasonable fee, shall have, as a matter of right, ready and immediate access to the credit information pertinent to the borrower. In case of erroneous, incomplete or misleading credit information, the subject borrower shall have the right to dispute the erroneous, incomplete, outdated or misleading credit information before the Corporation. The Corporation shall investigate and verify the disputed information within five (5) working days from receipt of the complaint. If its accuracy cannot be verified and cannot be proven, the disputed information shall be deleted. The borrower and the accessing entities and special accessing entities who have received such information shall be informed of the corresponding correction or removal within five (5) working days. The Corporation should use a simplified dispute resolution process to fast track the settlement/resolution of disputed credit information. Denial of these borrowers' rights, without justifiable reason, shall entitle the borrower to indemnity.

Section 5. *Establishment of the Central Credit Information Corporation*. - There is hereby created a Corporation which shall be known as the Credit Information Corporation, whose primary purpose shall be to receive and consolidate basic credit data, to act as a central registry or central repository of credit information, and to provide access to reliable, standardized information on credit history and financial condition of borrowers.

(a) The Corporation is hereby authorized to adopt, alter, and use a corporate seal which shall be judicially noticed; to enter into contracts; to incur liabilities; to lease or own real or personal property, and to sell or otherwise dispose of the same; to sue and be sued; to compromise, condone or release any liability and otherwise to do and perform any and all things that may be necessary or proper to carry out the purposes of this Act.

(b) The authorized capital stock of the Corporation shall be Five hundred million pesos (P500,000,000.00) which shall be divided into common and preferred shares which shall be nonvoting. The National Government shall own and hold sixty percent (60%) of the common shares while the balance of forty percent (40%) shall be owned by and held by qualified investors which shall be limited to industry associations of banks, quasi-banks and other credit related associations including associations of consumers. The amount of Seventy-five million pesos (PhP75,000,000.00) shall be appropriated in the General Appropriations Act for the subscription of common shares by the National Government to represent its sixty percent (60%) equity share and the amount of Fifty million pesos (PhP50,000,000.00) shall be subscribed and paid up by such qualified investors in accordance with Section 5(d) hereof.

(c) The National Government may subscribe or purchase securities or financial instrument that may be issued by the Corporation as a supplement to capital.

(d) Equal equity participation in the Corporation shall be offered and held by qualified private sector investors but in no case shall each of the qualified investor represented by an association of banks, quasi-banks and other credit-related associations including the associations of consumers have more than ten percent (10%) each of the total common shares issued by the Corporation.

(e) The SEC in coordination with relevant government agencies, shall prescribe additional requirements for the establishment of the Corporation, such as industry representation, capital structure, number of independent directors, and the process for nominating directors, and such other requirements to ensure consumer protection and free, fair and healthy competition in the industry.

(f) The Chairman of the SEC shall be the Chairman of the Board of Directors of the Corporation. Whenever the Chairman of the SEC is unable to attend a meeting of the Board, he/she shall designate an Associate Commissioner of the SEC to act as his/her alternate.

The powers and functions of the Corporation shall be exercised by a board of directors composed of fifteen (15) members. The directors representing the government shares shall be appointed by the President of the Philippines.

(g) The directors and principal officers of the Corporation, shall be qualified by the "fit and proper" rule for bank directors and officers. To maintain the quality of management of the Corporation and afford better protection to the system and the public in general, the SEC in coordination with the relevant government agencies, shall prescribe, pass upon and review the qualifications and disqualifications of individuals elected or appointed directors of the Corporation and disqualify those found unfit. After due notice to the board of directors of the Corporation, the SEC may disqualify, suspend or remove any director who commits or omits an act which render him unfit for the position. In determining whether an individual is fit and proper to hold the position of a director of the Corporation, due regard shall be given to his integrity, experience, education, training and competence.

The members of the Board of Directors must be Filipino citizens and at least thirty (30) years of age. In addition, they shall be persons of good moral character, of unquestionable integrity, of known probity, and have attained competence in the fields of law, finance, economics, computer science or information technology. In addition to the disqualifications imposed by the Corporation Code, as amended, no person shall be nominated by the national government if he has been connected directly with a banking or financial institution as a director or officer, or has substantial interest therein within three (3) years prior to his appointment.

(h) The Board of Directors may appoint such officers and employees as are not otherwise provided for in this Act, define their duties, fix their compensations and impose disciplinary sanctions upon such officers and employees, for cause. The salaries and other compensation of the officers and employees of the Corporation shall be exempt from the Salary Standardization Law. Appointments in the Corporation, except to those which are policy-determining, primarily confidential or highly technical in nature, shall be made only according to the Civil Service Law.

(i) The Corporation shall acquire and use state-of-the-art technology and facilities in its operations to ensure its continuing competence and capability to provide updated negative and positive credit information; to enable the Corporation to relay credit information electronically as well as in writing to those authorized to have access to the credit information system; and to insure accuracy of collected, stored and disseminated credit information. The Corporation shall implement a borrower’s identification system for the purpose of consolidating credit information.

(j) The provisions of any general or special law to the contrary notwithstanding, the importation by the Corporation of all equipment, hardware or software, as well as all other equipment needed for its operations shall be fully exempt from all customs duties and from all other taxes, assessments and charges related to such importation.

(k) The Corporation shall have its principal place of business in Metro Manila, but may maintain branches in such other places as the proper conduct of its business may require.

(l) Any and all acquisition of goods and services by the Corporation shall be subject to Procurement Laws.

(m) The national government shall continue to hold sixty percent (60%) of the common shares for a period not to exceed five (5) years from the date of commencement of operations of the Corporation. After the said period, the national government shall dispose of at least twenty percent (20%) of its stockholdings in the Corporation to qualified investors which shall be limited to industry associations of banks, quasi-banks and other credit-related associations, including associations of consumers. The national government shall offer equal equity participation in the Corporation to all qualified investors. When the ownership of the majority of the common voting shares of the Corporation passes to private investors, the stockholders shall cause the adoption and registration with the SEC of the amended articles of incorporation within three (3) months from such transfer of ownership.

Section 6. *Confidentiality of Credit Information*. - The Corporation, the submitting entities, the accessing entities, the outsource entities, the special accessing entities and the duly authorized non-accessing entities shall hold the credit information under strict confidentiality and shall use the same only for the declared purpose of establishing the creditworthiness of the borrower. Outsource entities which may process and consolidate basic credit data are absolutely prohibited from releasing such data received from the Corporation other than to the Corporation.

The accreditation of an accessing entity, a special entity and/or an outsource entity which violates the confidentiality of, or which misuses, the credit information accessed from the Corporation, may be suspended or revoked. Any entity which violates this section may be barred access to the credit information system and penalized pursuant to Section 11 of this Act.

The Corporation shall be authorized to release and disclose consolidated basic credit data only to the Accessing Entities, the Special Accessing Entities, the Outsource Entities and Borrowers. Basic Consolidated basic credit data released to Accessing Entities shall be limited to those pertaining to existing Borrowers or Borrowers with pending credit applications. Credit information shall not be released to entities other than those enumerated under this Section except upon order of the court.

Section 7. *Educational Campaign*. - A continuing nationwide educational campaign shall be developed and undertaken by the Corporation to promote the benefits of a credit information system to the economy; to create awareness on the rights of consumers/borrowers to access their credit reports collected, stored and disseminated by the Corporation; to disseminate the rights of the borrowers to dispute any incorrect/inaccurate credit information in the database file of the Corporation; to familiarize consumers of the procedure in collecting, storing and disseminating credit information of borrowers by the Corporation; and to brief consumers of other related information.

Section 8. *Rules and Regulations*. - For purposes of creating a healthy balance between the need for reliable credit information and safeguarding consumer protection, ensuring free and healthy competition in the industry, the SEC, in coordination with relevant government agencies and existing industry stakeholders, shall issue the implementing rules and regulations (IRRs), which shall be reviewed, revised and approved by the Oversight Committee to ensure consistency and compliance with the provisions of this Act, embodying among others:

(a) The basic credit data shall be limited or confined in form and content to an objective and factual information and shall exclude any subjective information or opinion;

(b) Restrictions on the use and transfer of credit information;

(c) Rights of the borrowers to access their respective credit information and to dispute the factual accuracy of such credit information;

(d) Requirements and standards for the establishment of the Corporation including, but not limited to, ownership, industry representation, independent directors and process of nomination of directors;

(e) Accreditation standards for submitting entities and special accessing entities and non-accessing entities;

(f) Sanctions to be imposed by the Corporation on:

(i) The submitting entities for non-submission of reports and for delayed and/or erroneous reporting;

(ii) Accessing entities, special accessing entities, outsource entities and duly authorized non-accessing entities, for breaches of the confidentiality of misuse of, the credit information obtained from the credit information system; and

(iii) Violations of other applicable rules and regulations: *Provided*, That these administrative sanctions shall be in the form of fines in amounts as may be determined by the Corporation but in no case to exceed Thirty thousand pesos (PhP30,000.00) a day for each violation, taking into consideration the attendant circumstances, such as the nature and gravity of the violation or irregularity. Imposition of administrative sanctions shall be without prejudice to any criminal and other sanctions as may be applicable under this Act and relevant laws;

(g) Suspension or cancellation of the rights of any Accessing Entity or Special Accessing Entity to access Credit Information from the Corporation; *Provided*, That the SEC in coordination with relevant government agencies and existing industry stakeholders, may issue subsequent regulations consistent with the IRR as approved by the Congressional Oversight Committee.

In addition, the SEC may regulate access to the credit information system as well as the fees that shall be collected by the Corporation from the Accessing and Special Accessing Entities, taking into consideration the policy of lowering the cost of credit, promoting fair competition, and the need of the Corporation to employ state-of-the-art technology; and

(h) The basic credit data about a borrower shall be limited to credit information existing on the date of the enactment of this Act and thereafter.

Section 9. *Congressional Oversight Committee*. - There is hereby created a congressional oversight committee, composed of seven (7) members from the Senate and seven (7) members from the House of Representatives. The Members from the Senate shall be appointed by the Senate President with at least three (3) Senators representing the minority. The Members of the House of Representatives shall be appointed by the Speaker with at least three (3) members representing the minority. After the Oversight Committee approved the implementing rules and regulations, it shall thereafter become *functus officio*, and therefore cease to exist: *Provided*, That the Congress may revive the Congressional Oversight Committee in case of a need for any major revision/s in the implementing rules and regulations.

Section 10. *Indemnity in Favor of the Corporation, its Officers and Employees*. - Unless the Corporation or any of its officers and employees is found liable for any willful violation of this Act, bad faith, malice and/or gross negligence, the Submitting Entities, Accessing Entities, Special Accessing Entities, Outsource Entities and duly authorized non-accessing entities shall hold the Corporation, its directors, officers and employees free and harmless to the fullest extent permitted by law and shall indemnify them from any and all liabilities, losses, claims, demands, damages, deficiencies, costs and expenses of whatsoever kind and nature that may arise in connection with the performance of their functions without prejudice to any criminal liability under existing laws.

Section 11. *Penalties*. - Any person who willfully violates any of the provisions of this Act or the rules and regulations promulgated by the SEC in coordination with the relevant government agencies shall, upon conviction, suffer a fine of not less than Fifty thousand pesos (PhP50,000.00). nor more than One million pesos (PhP1,000,000.00) or imprisonment of not less than one (1) year nor more than five (5) years, or both, at the discretion of the court.

Section 12. *Inviolable Nature of the Secrecy of Bank Deposits and/or Client Funds*. - Pursuant to Republic Act No. 1405 (Law on Secrecy of Bank Deposits), Republic Act No. 6426 (The Foreign Currency Deposit Act), Republic Act No. 8791 (The General Banking Law of 2000), Republic Act No. 9160 (Anti-Money Laundering Law) and their amendatory laws, nothing in this Act shall impair the secrecy of bank deposits and and/or client funds and investments in government securities or funds.

Section 13. *Annual Report*. - The SEC shall submit an annual report to Congress on the status of the implementation of this Act.

Sec. 14. *Principal Government Agency.* - The SEC shall be the lead government agency to implement and enforce this Act. As lead agency, the SEC shall consult and coordinate with other relevant government agencies in the adoption of all rules and regulations for the full and effective implementation and enforcement of this Act, taking into account the policy objectives contained in Section 2 hereof.

Section 15. *Separability Clause*. - Should any provision of this Act or the application thereof to any person or circumstance be held invalid, the other provisions or sections of this Act shall not be affected thereby.

Section 16. *Repealing Clause*. - This Act repeals Presidential Decree No. 1941 in its entirety. All laws, decrees, executive orders, rules and regulations or parts thereof which are inconsistent with this Act are hereby repealed, amended or modified accordingly.

Section 17. *Effectivity Clause*. - This Act shall take effect fifteen (15) days following its publication in the *Official Gazette* or in at least two (2) newspapers of general circulation

BAN ON UNFAIR DEBT COLLECTION PRACTICES OF FINANCING ANG LENDING COMPANIES AND LENDING COMPANIES

The Securities and Exchange Commission has just issued new rules prohibiting several controversial abusive means to collect debts.

As access to credit increases, so do the amount of controversies associated with the collection of debts. In recent months, the Securities and Exchange Commission (SEC) has reported numerous complaints against financing and lending companies, as well as their outsourced collection agents, who allegedly had been employing harassing tactics against debtors. Some of these tactics include using barangay officials or men in uniform to force a borrower to pay, calling the debtor's employer to smear their name, bombarding the debtor with text messages, and making false representations such as claiming that a hold departure order has been issued against the debtor.

As far back as 2004, the Bangko Sentral ng Pilipinas had already issued **Circular No. 454**, which among others, prohibits unfair collection practices by banks, subsidiary/affiliate credit card companies and their agents (such as collection agencies). Financing and lending companies though are under the supervision and regulation of the SEC[1]. In response to these complaints, the SEC has now issued its own regulatory circular, **Memorandum Circular No. 18 (Series of 2019)**, which prohibits several unfair debt collection practices of financing and lending companies.

What is prohibited?

Financing and lending companies, as well as their third-party service providers, are allowed to exert "reasonable and legally permissible means"[2] to collect on debts, provided they observe "good faith and reasonable conduct and refrain from engaging in unscrupulous and untoward acts."[3] To ensure that the covered companies adhere to this limitation, the SEC has enumerated which activities constitute prohibited unfair collection practices:

- Notwithstanding the borrower's consent, contacting persons in the borrower's contact list other than the guarantors or co-makers of the loan,
- Use or threat of use of violence or other criminal means to harm the physical person, reputation, or property of any person
- Use of threats to take any action that cannot be legally taken
- Use of obscenities, insults, or profane language to abuse the borrower and/or which use constitutes a criminal act or offense under applicable laws
- Use of false representation or deceptive means to collect or attempt to collect any debt or to obtain information concerning a borrower
- Communicating or threatening to communicate to any person loan information, which is known or which should be known to be false. The failure to communicate that the debt is being disputed is deemed as included in this prohibition.

- Making contact at unreasonable/inconvenient times or hours (i.e., before 6am or after 10pm), unless the account is past due for more than 15 days, or if the borrower had previously consented to be contacted at such hours.

Privacy and Confidentiality

The SEC Memorandum Circular refers to the applicability of the Data Privacy Act (among other laws) and imposes a general rule that financing and lending companies, for purposes of collection, shall keep strictly confidential the data on the borrower. There are however prescribed exceptions in Section 2 of the Circular when the companies may disclose such information:

- Where the disclosure of information is with the written or recorded consent of the borrower
- The release, submission or exchange of customer information with other financial institutions, credit information bureaus, lenders (potential or actual), their agents and/or their representatives
- Upon orders of a court of competent jurisdiction or any government office or agency authorized by law
- Disclosures to agents of the companies such as collection agencies and counsels, in order to enforce the companies' rights against the borrower
- Disclosures to third party service providers solely for the purpose of assisting or rendering services to the companies in the administration of its lending or financing business
- Disclosure to third parties such as insurance companies, solely for the purpose of insuring the companies against borrower default or other credit loss, and the borrower from fraud or unauthorized charges.

Penalties

The penalties imposed on financing and lending companies are prescribed in Section 5, and are potentially steeped. Fines are imposed on the first and second offenses, but a third offense may lead, upon the discretion of the SEC, to the temporary suspension of lending and financing activities, if not the revocation of the license to operate of the company.

[1] See Sec. 11, Republic Act No. 9474 and Sec. 4, Republic Act No. 5980, as amended by Republic Act No. 8556.[2] Sec. 1, SEC M.C. No. 18 (2019)[3] Sec. 1, SEC M.C. No. 18 (2019)

ASSESSMENT

OVERVIEW OF CREDIT

IDENTIFICATION			
1	One wherein the interest is automatically deducted from the principal at the time it is granted	1	
2	It refers to the borrower's payment habits and attitudes	2	
3	The ability to obtain things of value in exchange for a promise to pay at some future date	3	
4	Loan the repayment of which will come from the income derived from the use of the principal	4	
5	It refers to the borrower's ability to pay	5	
6	It allows us to shop and travel without having to carry large amounts of cash	6	
7	Loans granted by government institutions	7	
8	Credit issued without collateral	8	
9	It refers to the borrower's net worth position	9	
10	Loans granted by commercial enterprises, banks and other financial institutions	10	
11	It refers to any asset which may be pledged against the debt	11	
12	Credit issued without collateral	12	
13	Loan used to finance short-term working capital needs	13	
14	Loan payable for more than five years	14	
15	Loans granted to individuals to facilitate the consumption of goods and services	15	
16	It refers to economic factors which may affect the borrower's ability to pay	16	
17	Loans used to finance agricultural needs	17	
18	Loan used to finance the acquisition of and improvement of real properties	18	
19	Loan payable within a year	19	
20	Loan granted to finance long-term capital needs	20	

TRUE OR FALSE			
1	Prime rate is the highest interest rate offered by banks	1	
2	Time loan is payable upon demand	2	
3	Technology innovation can completely alter industry profile	3	
4	Consumer loans are usually long-term	4	
5	Real estate loans are usually short-term	5	
6	Diversifying the loan portfolio minimizes the risk	6	
7	Income alone completely reveals capacity	7	
8	Short-term needs must be financed with long-term capital	8	

9	The stage in business cycle is important as it impacts directly consumer and industrial demand, sales, supply, prices, etc.	9	
10	Loan discounting makes the loan more expensive	10	
11	Long-term needs must be financed with short-term capital	11	
12	The most important evidence of capacity is income	12	
13	The larger the amount, the greater the aggregate risk to the lender	13	
14	It is important that the purpose for which the loan will be used be productive to enable the borrower to repay the obligation incurred	14	
15	The longer the time, the greater the risk	15	

ESSAY

1. Who do you think assumes the risk in a credit transaction? Why?

2. Among the Cs of good credit, which do you think is the most important? Why?

3. Have you experienced borrowing/lending? What were the advantages and disadvantages you incurred?

CREDIT MANAGEMENT

IDENTIFICATION			
1	The process by which risks that are inherent in the credit process are managed and controlled	1	
2	It shows the proportion of applicants for credit that are accepted	2	
3	The credit man has the ability to effectively convey his ideas	3	
4	The credit man knows his areas of responsibility	4	
5	Risk which is present primarily in the loan disbursements and credit administration process	5	
6	It measures the proportion of all past due accounts, in amount or in number	6	
7	The credit man does not only act with certainty but also with swiftness and speed	7	
8	The risk of repayment	8	
9	The credit man does not unnecessarily deviate from policies and guidelines	9	
10	The credit man has good public relations both within and outside the organization	10	
11	It is computed by dividing credit sales by total net sales	11	
12	It is computed by dividing the total sales by the average accounts receivables outstanding	12	
13	The credit man is positive in his approach to both credit and collection management	13	
14	It is determined by dividing the total amounts collected during a period by total receivables outstanding at the beginning of that period	14	
15	The potential that events may have an adverse impact on earnings or capital	15	

TRUE OR FALSE			
1	Loans can be used as collateral for borrowings	1	
2	The first defense against credit risk is the initial credit-granting process	2	
3	Liquidity is not affected by the committed amount to lend and the actual amount that borrowers draw against those commitments	3	
4	Losses may be incurred because of the failure to perfect or renew collateral liens	4	

5	Credit positions vary according to the importance given to the position by top management	5	
6	An increased credit risk may be incurred when information systems failed to provide adequate information	6	
7	A bank must observe limits on its loans to a single borrower	7	
8	Sound initial credit decisions can be undermined by improper loan structuring or inadequate loan monitoring	8	

ESSAY

1. What's the importance of the role played by the credit and collection department in an organization?

2. How can aging of account be used as a gauge in measuring the efficiency of credit and collection operation?

FORMULATION, COMMUNICATION AND IMPLEMENTATION OF CREDIT AND COLLECTION POLICIES

IDENTIFICATION			
1	Guides in the performance of the credit functions of the company	1	
2	Policy which affects the level of interest rates and the availability of funds	2	
3	A general guideline on how to act in ordinary or extra-ordinary situations that recur from time to time, bearing in mind the accomplishment of established company objectives	3	
4	Policy which influences the channeling of funds and spending patterns	4	
5	Maximum ratio of total loans to total assets allowed	5	

TRUE OR FALSE			
1	Credit policies must be flexible and responsive to changing conditions	1	
2	When times get tight, marginal customers often get into trouble	2	
3	The credit policies should be harmonious with established policies of the other departments within the company	3	
4	The credit policy must change as business conditions modify the credit strength of customers	4	
5	Financial condition of the company has much to do with the amount of credit exposure the company can take	5	
6	The extent of the details of credit policies vary from one company to another	6	
7	When times get tight, companies often get highly leveraged	7	
8	The wider the profit margin, the more liberal is the collection policy	8	
9	Environmental climate needs to be kept in mind as swings in priorities may affect the borrower	9	
10	Credit departments of banks are more organized and they receive top management attention	10	
11	The credit policy should be stated in clear and unmistakable terms	11	
12	Changes in government spending does not affect the borrower's business	12	
13	Industry practices have no bearing on the credit policy of individual member companies in the industry	13	
14	No policy achieves maximum effectiveness unless it is accompanied by a periodic check up to insure its proper implementation	14	
15	Credit policies are designed to meet credit objectives	15	

ESSAY

1. What's the importance of having a credit and collection policy?

2. How can the external factors affect the crafting of a credit and collection policy?

TARGET MARKET IDENTIFICATION, PRE-SCREENING OF LOAN APPLICATION AND LOAN EVALUATION

IDENTIFICATION			
1	It is done by taking a cursory review of the application	1	
2	It refers to the verification of information related to the applicant and related interest business	2	
3	It refers to the property which the borrower puts up to repay a loan in cases of default	3	
4	The highest price estimated in terms of money which a property will bring if exposed for sale in the market	4	
5	A process where the lending unit identifies the client base and credit program facilities it will pursue	5	
6	The conveyance of a real estate as security for the payment of a loan	6	
7	It refers to the gathering of additional or confirmation of information related to the applicant's job	7	
8	It is conducted on all credit applications to immediately ascertain applicant's creditworthiness	8	
9	It is an estimate or opinion of value	9	
10	The process where the account officer evaluates all credit information about the borrower	10	
11	Similar to REM except that the subject is chattel or personal property	11	
12	Refers to the introductory and exploratory discussions the account officers do in relation to credit initiation	12	
13	It involves inquiry from existing credit records	13	
14	The transfer or setting over of deposit or of rights or interest therein from one person to another	14	
15	It involves inquiry against compilation of names of persons against whom collection cases have been filed by creditors	15	
16	This is executed when the borrower is not the owner of the offered collateral	16	
17	Also known as suretyship where a surety binds himself solidarily with the principal debtor	17	
18	It determines the character of the client and his paying habit thru creditors	18	
19	It exists when a person or company guarantees the loan of another and vice versa	19	

TRUE OR FALSE			
1	All credit applications except those rejected outright are checked against existing credit and court case records	1	
2	The borrower's collateral shall always be the primary consideration in the extension of credit	2	
3	Market value is the price under which a willing seller will sell and a willing buyer will buy, neither being under abnormal pressure	3	
4	It is essential that the mortgagee be the absolute owner of the property being mortgaged	4	
5	Collateral accepted shall be properly documented and registered in favor of the lender	5	
6	If the borrower pays the loan on maturity, the hold-out on deposits become null and void	6	
7	In credit evaluation, character and capacity should come first	7	
8	The value most commonly sought in an appraisal is book value	8	
9	One must refrain from establishing personal involvement with the borrower to avoid "clientism"	9	
10	A careful analysis of the financial condition of the borrower is one of the vital components of credit evaluation	10	

CREDIT AND COLLECTION PROCEDURE

(TARGET MARKET IDENTIFICATION, PRE-SCREENING)

1. Why is there a need to identify your target market?
2. What is the importance of requiring the loan applicant to fill-out an application form?

CREDIT AND COLLECTION PROCEDURE

(CREDIT INVESTIGATION, APPRAISAL, EVALUATION)

1. What is the importance of conducting credit investigation?
2. Should you obtain information about the borrower's age, health, character and reputation, family life and relationships and his residence? Why?
3. What is the importance of appraising the value of collateral?
4. Will you extend loan even without collateral? Why?

MIDTERM EXAMINATION

1. If you are the borrower, which will you avail - a discounted or an ordinary loan? Why? If you are the lender, which will you grant – a discounted or an ordinary loan? Why?
2. How are you going to minimize the risks inherent in lending?
3. Which will you prefer, a strict or a liberal credit and collection policy? Why?
4. Will you grant loans even without conducting credit investigation? Why?
5. If the borrower has no regular income but has a collateral to offer, are you going to extend loan? Why?

6. Ciregor Plastics Manufacturing Corporation is into the manufacture of polyethylene and polypropelene plastic sheets and packaging materials. The company has been in the business since 1990's supplying the packaging needs of close to 250 SMEs. Most of its customers are processors of snack foods that are sold both in supermarkets and sari-sari stores. Sales are growing as new orders arrive continuously.

   Manufacturing capacity utilization is already reaching 95% but the owner of the company sees that sales would multiply by 1.5x by end of the year and almost double by the following year. In order to meet expanding demand, the company has to acquire additional extrusion machines and printers that are worth more or less P300K. Likewise, the company would need additional working capital of about P150K.

   a. Evaluate the company and its need for credit
   b. Prepare a credit proposal indicating the need and purpose, if warranted
   c. Provide at least five major terms and conditions of the credit
   d. Identify at least two significant risks that the company might not be able to pay and provide their mitigating measures
   e. State at least three justifications/reasons why the company should be given credit

LOAN PACKAGING AND APPROVAL

IDENTIFICATION			
1	It covers the results of the appraisal conducted on the collaterals offered	1	
2	The contract between the lender and the client covering the grant of loan by the former to the latter	2	
3	A document disclosing to the client the details of the loans to be released	3	
4	It contains the highlights of the proposal	4	
5	It identifies areas in the credit operation that need improvement and recommend corrective action	5	
6	This is used to document new terms and conditions affecting loan transaction in instances where the borrower fails to meet hi maturing obligations	6	
7	It refers to proper provision of credit support, control systems and other practices necessary to manage outstanding risk assets	7	
8	It shows the results of the credit investigation conducted	8	
9	Refers to all documents that are related to the account	9	
10	Core document covering the terms and conditions whereby the proceeds of the credit facility	10	
11	This generally shows the action plan as well as results of recovery measures on distressed accounts	11	
12	A type of mortgage given to a trustee for the purpose of securing numerous creditors	12	
13	It provides feedback on the overall credit risk assessment	13	
14	Contains a brief background on the applicant, the project, the products and services, the market and the affiliates	14	
15	An unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time	15	
TRUE OR FALSE			
1	Should the account be denied, a denial/disapproval notice shall not be sent	1	
2	Account officers should serve as witness to the signing of all legal documents and should verify the signatures of borrowers to ascertain authenticity	2	
3	Only one person should approve or effect a release	3	
4	Fund matching principle must be observed	4	

5	Deviations from standard terms and conditions can be done even without prior approval	5	
6	Remedial action should be promptly instituted to keep the account in current status	6	
7	Credit decision can be based entirely on a static set of credit guidelines or analytical technique	7	
8	Credit folders must be treated with confidentiality	8	
9	The review validates the effectiveness of the credit monitoring	9	
10	The structure of a credit package should be clearly stated	10	
11	All necessary legal documents prior to the initial release/restructuring or availment should be secured	11	
12	The security documents can exist even without the principal lending documents	12	
13	Names of all signatories should be printed	13	
14	The repayment mode shall be structured based on the purpose of credit being applied for	14	
15	Release of collateral is allowed after partial payment of the loan	15	

ESSAY

1. Why should fund matching principle be observed in structuring the terms and conditions of a credit transaction?
2. Should the account be denied, a denial/disapproval notice shall likewise be sent. Why?
3. Why is there a need for a disclosure statement?
4. Releases should pass through different authorized signatories. No one person or division can singularly approve or effect a release. Why?

PROBLEM ACCOUNTS AND REMEDIAL ACCOUNT MANAGEMENT

IDENTIFICATION			
1	The art of preventing the occurrence of, and bringing about prompt and satisfactory conclusion to problem account situations	1	
2	Locating missing customers	2	
3	Covers lump sum payment either through cash payment and generally includes penalty charges	3	
4	One in which there is a major breakdown in the repayment agreement resulting in an undue delay in collection	4	
5	Procedure by which mortgaged property is sold upon default of a mortgagor in satisfaction of mortgaged debt	5	

MATCHING TYPE

A. Causes of lending problems

	1	Failure to detect early warning signals	Choices: A – Loan Packaging B – Customer Related Factor C – Related Factor
	2	Dominance by one or few officers	
	3	Lack of professionalism of officers	
	4	Neglect of basic criteria and standards	
	5	Dependence on one product line	
	6	Inadequate loan agreement provisions	
	7	Setting aside the capability of client to run the project	
	8	Unrealistic high targets on loan releases	
	9	Inappropriate amortization schedule	
	10	Neglect of basic credit criteria	
	11	Inability of management to cope with changes	
	12	Unclear loan purpose	
	13	Inappropriate timing of projects	
	14	Lapses in loan implementation	
	15	Source of payment is not tangible or quantifiable	
	16	Short-term borrowings used for acquisition of fixed assets	
	17	Giving in to competitive pressures	
	18	Weak second way out	

	1	Low sales turnover	
	2	Build-up of receivables	
	3	Deteriorating cash position	

	4	Diversion of funds/loan proceeds	Choices: A – Violation of loan agreement provision B – Internal problems C – Financial indicators D – Non-financial Indicators
	5	Increasing collection period	
	6	Rise in inventory costs	
	7	Marked difference between projections and actual operations	
	8	Marked decline in current assets	
	9	Competitive operations	
	10	Unreasonable request for substantial increase in credit	
	11	Lapses in installment payments	
	12	Investment in non-related ventures of business	
	13	Increase in liabilities	
	14	Fast turn-over of employees without justifiable reasons	
	15	Waiver of safeguards against default	
	16	Squabble among stockholders	
	17	Returned checks to suppliers and creditors	
	18	Flurry of insolvencies or bankruptcies	
	19	Unremitted collection	
	20	Substantial rumors about the unsatisfactory credit habits of the debtor	
	21	Buying at big volumes and selling at cost	
	22	Sudden unexplainable decrease in manpower	Choices: A – Violation of loan agreement provision B – Internal problems C – Financial indicators D – Non-financial indicators
	23	Willfull default among members	
	24	Poor appearance of the office	
	25	Decline in net worth	
	26	Diminishing margin of profitability	
	27	Habitual issuance of bouncing checks	
	28	New laws adversely affecting a debtor’s business	
	29	Failure to submit financial statements on time	
	30	Increasing bad debts	
	31	Rising operating expenses	
	32	Insufficiency or lack of insurance coverage	
	33	Management shake-up	
	34	Dishonesty of officers	
	35	Disappearance of officers/assets	
	36	Rising sales, falling profits	
	37	Unscheduled BOD reorganization	

ESSAY

1. Choose 4 loan packaging and 3 customer-related factors and explain how they may cause lending problems
2. Choose 5 financial factors and 5 non-financial factors and explain why they are considered early warning signals of weakened accounts
3. Why should there be no work-out within a work-out?
4. What is the importance of credit review?

LEGAL ASPECTS OF CREDIT AND COLLECTION

ESSAY

1. Cite the highlights of the related laws in credit and collection.

FIMA 30063 - CREDIT AND COLLECTION

By: Bernadette M. Panibio

FINAL EXAMINATION

1. Litigation is a good alternative but the last one to be considered when everything else has failed. Agree or disagree? Why?
2. What are you going to do if your debtors are harsh and difficult to deal with? You have shown understandings, you have tried all amicable ways of negotiating, rescheduling agreements etc., yet your debtor turns a blind eye on you. Moreover, your claim is based on some commercial papers (unpaid invoices, bills of lading and letters of credit) and your debtor creates some doubt over their validity, the applicable interest rates (if any) and so on.

3. Considering the related laws on credit and collection given in this instructional material, which provisions stated in those laws are pro-debtor and pro-creditor? Why?

4.Give an illustration of the entire credit and collection procedure and cite the highlights on each stage