Selected Cases in Banking

Editors
Dr Sarita Bhatnagar
Dr V S Kaveri

National Institute of
Bank Management
Pune

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National Institute of Bank Management (NIBM) was established in 1969 by the Reserve Bank of India as an autonomous apex institution for research, training and consultancy in banking and finance. The mandate of the Institute is to play a proactive role of a "think-tank", to give new direction to the banking industry while helping banks in their endeavour to become competitive, both in domestic and international markets. The Institute also serves banks and financial institutions in many developing countries. As an autonomous academic Institution, NIBM is governed by a Governing Board, with traditionally Governor, Reserve Bank of India as its Chairman.

Leveraging its core competencies in research, training and consultancy to the banking and financial services sector, NIBM started the Post-Graduate Diploma in Management (Banking and Financial Services) with the objective of developing young executives to lead the banking and financial services sector.

The Institute is located in sylvan surroundings in a picturesque valley within the Pune city in the state of Maharashtra. Spread over a 60-acre area, the campus is self-contained with its own residential and educational facilities. The railway station is located at a distance of 9 kms while the airport is 16 kms away.

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Foreword

The National Institute of Bank Management is dedicated towards capacity building and thought leadership in banking and financial services. In its quest towards enriching the training initiatives in banking one of the thrust areas, is encouraging the participant centred learning through case studies. Facilitating this vision of NIBM, I am pleased to present the e-book "Selected Cases in Banking". I am sure the trainer community at large would like to take the benefit of efforts put in by NIBM Faculty Team and utilize them in promoting learning through training.

I take this opportunity to mention the salient characteristics of the book. It is based on real life decision making situations in banking, which would help trainers to supplement their conceptual inputs with decision making skills for problem solving. The cases cover major areas of banking operations like lending, loan monitoring, recovery, risk management, marketing, information technology and international banking.

I appreciate the sincere efforts put in by members of Case Clearing House (CCH) comprising Dr Sarita Bhatnagar, Dr V S Kaveri, Dr Elizabeth James and Dr Smita Roy Trivedi for bringing out the compilation of selected cases. I am also thankful to the esteemed reviewers for their valuable inputs and insightful comments. I also acknowledge secretarial support extended by Ms Yvette D'Mello. Lastly, authors of our selected cases deserve a special appreciation for contributing to the practical knowledge based learning in banking operations.

Dr Arindam Bandyopadhyay
Acting Director

Prologue

National Institute of Bank Management (NIBM) has been conducting Training, Teaching, Research and Consultancy for banks and financial institutions. In this effort of knowledge creation and dissemination dedicated to capacity building in banks and financial institutions, NIBM Case Clearing House is one of the initiatives. The purpose is to enrich the executive training in banking by encouraging use of cases in training programmes. The e-book "Selected Cases in Banking", has been brought out to share with the training fraternity, cases that can be used to enhance learning experience on decision making scenarios in banking. The cases in the Book have been selected by a rigrous blind review process involving experienced industry experts. Suggesstions by reviewers have been incorporated and cases have been suitably edited by the editorial committee members.

The eleven cases included in the compilation are in the areas of credit appraisal, credit management, monitoring, recovery, due diligence, risk management, marketing management, information technology and international banking.

The first case "Life Cycle Approach in Credit Management : A Case on Bank's Loan Appraisal", focuses on significance of data validation, vetting of project outlay, due diligence etc., to be addressed for effective credit management under loan life cycle.

Case study "Managing Credit when Company's Survival Becomes Questionable - A Case of M/s Smart Textitles Ltd., discusses the handling of a large borrower account under consortium in circumstance of liquidity and financial difficulties as well as risk of dilution in existing securities provided to the bank for credit limits.

Case titled "Credit Monitoring and Portfolio Supvervision: Key Towards Effective Credit Management", attempts to highlight the significant aspects to be monitored in existing and prospective credit portfolios to prevent slippage and take timely corrective measures.

The Case "Early Warning Signals: Catch them Young", identifies the various early warning signals, their detection importance and application to improve the asset quality.

Case "Due Diligence in Qualitative and Quantitative Aspects", is set up in a branch situation and demonstrates the various facets of assessing the viability of a credit proposal considering both the qualitative and quantitative aspects to make the takeover of credit facilities and limit enhancement decisions.

Case "Risk Management : A Case Study on Derivatives", aims to demonstrate the key dimensions of Risk Management and understand the impact of excessive leverage, impact of timing of markets, importance of adhering to regulatory guidelines and importance of mark to market/stop loss.

Case "Direct Marketing vs Referral Marketing - A Case Study of a Cooperative Bank", highlights the importance of relationship banking, marketing challenges in a cooperative bank, implementation of direct marketing and referral marketing strategy and examines the pros and cons of these strategies.

Case "Digital Tools for Preventing Frauds in Corporate Loans", describes the present scenario regarding corporate loan fraud, the various digital tools like CERSAI, MCA 21, CIBIL, etc., available in preventing corporate loan fraud and deals with aspects of monitoring big ticket size borrowers digitally. Case "Data Breach and Cyber Attacks : The Case of Bankcorp" illustrates hacking in a financial institution, bank's response in crisis and debate on different responses that could have been adopted. It also describes the different cyber attack modes and mechanisms developed by banks to brace against these.

The case "Digital Tools and Recovery", helps understand recovery of retail loans using various digital tools. It describes using various retail default situations, how digital tools and platforms help trace borrowers as well as identify the pressure points.

The last case "Foreign Letter of Credit", demonstrates the distinguisting features of letter of credit in facilitating international trade.

All the cases are accompanied by Trainer Notes indicating the suggested pedagogy to be utilised in a training session. Authors have also indicated supplementary readings and relevant circulars by RBI for developing background of case analysis and discussion.

We are hopeful that the book "Selected cases in Banking", will be of great interest for trainers in banking and contribute towards strengthening the participant centered learning.

We express our heartfelt gratitude to the esteemed reviewers - Shri B V Chaubal, former Deputy Managing Director, State Bank of India, Shri S K Bajpai, former Deputy General Manager, State Bank of India and, Shri Rakesh Gupta, former General Manager , Punjab National Bank, and Shri Jayant Keskar, former Deputy General Manager , IDBI Bank Ltd. for their expert insights and inputs. We did like to thank the Publications Department team at NIBM for their support for copy editing, layout, and to bring the book in the present form.

We extend thanks to Acting Director NIBM, for the constant encouragement and support in bringing out this book.

Editors

Dr Sarita Bhatnagar
Dr V S Kaveri

Contents

Life Cycle Approach in Credit Management: A Case on Bank's Loan Appraisal

Dr Ram Jass Yadav

Loan life cycle begins from inquiries of a prospective borrower about the loan he needs and it ends when the borrower pays off the loan. Pre-sanction being a part of the loan appraisal includes collection of independent information and market intelligence on the potential borrowers from the public domain on their track record, validation of information from other sources like the Reserve Bank of India (RBI)/Ministry of Corporate Affairs (MCA)/Credit Information Bureau India Limited (CIBIL), which could be used as an input by the sanctioning authority. Disbursement stage of life cycle deals with compliance of terms and conditions, and rationale for allowing dilution of these terms and conditions. Annual review is a process of continuous monitoring of an account through the tracking of early warning signals. The present case study focuses on significance of data validation, vetting of project outlay, due diligence, related party transactions and key introductory questions required to be addressed for effective credit management under Loan Life Cycle (LLC).

Keywords: Credit Management, Loan Life Cycle, Loan Appraisal

Introduction

Meeting with potential borrowers, giving and receiving loan application, evaluating the credit proposal, approval of loan, executing documents, disbursing the money, credit monitoring and recovery of loan given to the borrowers is defined to be credit management in banking parlance. All the activities illustrated in this simple definition of credit management deserve special attention by a banker. Effective credit management sets specific criteria that a borrower must meet before receiving the proposal from him. Evaluation process envisages various steps such as gathering data on the potential borrower's current financial condition *viz.* credit track record that discloses the character of a customer in meeting obligations as well as collateral value. Good credit management not only safeguards the bank interest but also protects the customer from creating high debt obligations. Life cycle in credit is an important concept to give emphasis at each stage of credit cycle so that weaknesses escaped attention at one stage can be mitigated on subsequent stages. The purpose of this study is to identify critical questions to be considered and discussion on the areas to suggest possible solutions that can help field functionaries in ensuring clients prosperity and safeguarding the bank's interest.

ABC Company – A Case

M/s Ankur Food Industry Private Limited, in short 'Ankur Enterprises', promoted by three entrepreneurs Mr Anil, Mr Bhavik and Mr Chetan was incorporated on 22th January, 2013. Mr Anil, aged 40 years, is a Bachelor of Engineering (BE) degree. (Instrumentation) having 17 years of experience in Rice Mill sector and 5 years experience in power generation sector.

Dr Ram Jass Yadav (ramjassyadav@rediffmail.com) GM & Zonal Head, Bank of Baroda, Lucknow.

Mr Bhavik, 67 years old, is a commerce graduate with 50 years experience of Rice Mill business. Mr Chetan, 38 years, is also a commerce graduate with 18 years experience in scrap trading, 5 years in power generation and 3 year in rice trading. The company belongs to the "Maha Group" which is one of the emerging groups in India and overseas markets. The Group has achieved a turnover of more than Rs. 400.00 crores from domestic market and over Rs. 2,000 crores from overseas operations during the financial year 2012-13. The promoters have the track record of successfully implementing the projects undertaken by them. All the projects completed by the promoters are functioning well. The promoters have the required business acumen and experience in various fields with sufficient means to contribute in the project. The Group is operating in various lines of activities which include rice milling, trading in iron and steel, biomass power plant, flour mill, investment company, trading of steel scrap and mineral. After successful implementation of various projects and keeping in view the expected rise in demand for quality rice, the promoters have decided to set up a rice mill in Nagpur district to produce rice, broken rice and rice bran. Besides sale in the local markets, the produce is also planned to be exported to various rice consuming countries. Shareholding pattern of the company as on 31.03.2014 is given in Table 1.

Table 1

Shareholding Pattern of Ankur Enterprises as on 31.03.2014

Name of Share Holders	*No. of Shares*	*Amount (Rs.)*	*(%)*
Mr Anil	7,500	75,000	0.25
Mr Bhavik	2,500	25,000	0.08
United Deal Pvt. Ltd.	1,490,000	1,49,00,000	49.67
Maha Industries Pvt Ltd.	6,85,500	68,55,000	22.85
Krishana Vyapaar Pvt.Ltd.	8,14,500	81,45,000	27.15
Total	3,000,000	3,00,00,000	100.00

Nagpur branch of Trust Bank has canvassed the new business from Ankur Enterprises in June 2014 for term loan of Rs.15 crores and working capital of Rs.31 crores. to set up a rice mill along with Sortex Mill at Marodi in Nagpur district. Bank Guarantee of Rs.2 crores, as a part of working capital has been requested for bidding the tenders, mobilization of advance money, performance contracts and warranty in favour of government departments. Company requested concession of 1.65 per cent and 1.50 per cent in Applicable Rate of Interest (ROI) on Term Loan and Cash Credit facilities respectively. Effective ROI after proposed concession considered to be 11.90 per cent in both term loan and working capital loans. Also the borrowing company asked the Bank to: *(i)* waive Corporate Guarantee of M/s Maha Industries Pvt Ltd., incorporated outside India, currently having 22.85 per cent shareholding in the Company and *(ii)* to accept current ratio at 1.31 as on 31.03.2016. The Divisional Manager, Nagpur Division, Trust Bank has recommended said concession and waiver in credit proposal on the ground that Bharat Bank has granted facilities at 11.90 per cent rate of interest without corporate guarantee of M/s Maha Industries Pvt. Ltd.

During the processing of proposal, it was observed that CIBIL reports of the company, its directors and all other companies in which they are directors are in order, except overdue of Rs.1.72 lacs against Mr Chetan one of the directors of the Company. It was also subsequently confirmed that the said account is now regular and branch has obtained certificate from the concerned bank in the matter. Proposal internally observed to be of investment grade based on estimated/projected financials.

Company has consortium arrangement of banking with another nationalised bank, named Bharat Bank that has also sanctioned total credit facilities amounting to Rs.46.00 crores including term loan and working capital facilities to the Company. The proposed credit facilities from Trust Bank are secured from primary securities with security coverage of 1.33 and also collaterally secured with open plots valuing of Rs.3.19 crores in name of directors and individual guarantors besides Fixed Deposit Receipt (FDR), Kisan Vikas Patra (KVP) and National Savings Certificate (NSC) of Rs.7.13 crores in their names. Credit facilities are also secured from personal and corporate guarantee of individuals and corporate mentioned in Table 2.

Table 2

Guarantors and their Worth

(Amount in crores)

Name	*Net Worth**	*Name*	*Net Worth**	*Name*	*Net Worth**
Mr Anil	4.01	Smt Neha	2.61	Krishana Vyapaar Pvt.Ltd.	41.45
Mr Bhavik	2.38	Smt Seema	1.92	United Deal Pvt. Ltd.	9.86
Mr Chetan	30.28				

*Net worth taken as of 31st March 2013

The proposed Term Loan is repayable in 20 quarterly installments of Rs.0.75 crores each, commencing after the moratorium period of one year from the commercial operation date which is assumed to be in April 2015, thus repayment from quarter ending June 2016. However, monthly interest in the account is to be repaid, as and when debited in the account during the moratorium period.

Table 3

Repayment Plan of Term Loan

(Amount in crores)

Particulars	*2015-16*	*2016-17*	*2017-18*	*2018-19*	*2019-20*	*2020-21*
Net Profit	3.22	5.74	7.93	8.79	9.49	10.13
Depreciation	5.80	4.99	4.29	3.69	3.17	2.73
Interest on Loan	3.42	3.16	2.48	1.80	1.11	0.43
Principal - TL	0.00	5.70	5.70	5.70	5.70	5.70
Debt Service Coverage Ratio	3.64	1.57	1.80	1.90	2.02	2.17

Nagpur Branch of Trust Bank has obtained detailed project report with cost outlay of Rs.64.84 crores for the new project. Summary of cost outlay is given in Table 4. Company has purchased land for the project on 01.10.2013 for Rs.1.79 crores presently valued at Rs.2.79 crores The development cost of land is estimated to Rs.0.33 crores. Project is assumed to achieve 70 per cent capacity utilization in first year (2015-16) with 5 per cent annual increase in 2nd and 3rd year of its operations. Project implementation plan is given in Table 5.

Table 4
Project Outlay

(Amount in crores)

Cost of Project	*Amount*	*Means of Finance*	*Amount*
Land & Site Development	3.12	Capital	22.34
Building and Civil	9.11	Unsecured Loan	14.00
Plant & Machinery	29.37	Term Loans	28.50
Electrical Installation	0.50	Of which -	
Furniture Fixture and other asset	0.33	Indian Bank	15.00
Contingencies (2%)	0.79	Bharat Bank	13.50
Pre-operative Expenses	0.35		
Interest during construction period	2.03		
Subtotal	45.60		
Margin for Working Capital	19.24		
Total	64.84	Total	64.84

Table 5
Project Implementation Schedule

Nature of Activity	*Period*	*Nature of Activity*	*Period*
Acquisition of Land	Acquired	Orders to be placed for Machines	July 2014
Construction of Building and Shed	Sep 2014	Delivery of Plant & Machinery	Dec 2014
Installations & Erection	Feb 2015	Plant Commissioning & Trial Run	Mar 2015
Commercial Run	April 2015		

The Company has obtained license under Food Safety and Standard Act 2006. The Company has moved application for No Objection Certificate (NOC) from Maharashtra Pollution Control Board (MPCB) and also has submitted application to Maharashtra State Electricity Distribution Company Limited (MSEDCL). Promoters have subsequently requested after sanction of term loan that the conditions of pledging FDR/KVP/NSC of Rs.7.31 crores to be substituted by collateral in form of an open plot in their individual names. The abridged form of projected financials of the company and key financials of group entities is given in Annexure I and II respectively. Exposure of both the banks to the company project is almost equal but Bharat Bank has been decided to be lead bank in the case because group is dealing with Bharat Bank and have good reputation with their branch staff and top executives.

It is informed on 31st May 2015, that first installment of term loan disbursed on 15.10.2014 from Trust Bank and small amount of term loan is pending for disbursement. Interest found to be serviced from current account. Working capital limit also released on 05.03.2015 and observed to be withdrawn by promoters in their individual names and also in associate group entities.

Summing Up

The fundamental mistakes in appraisal are normally done when banks extrapolate past growth and performance to the future. Banks may have expected the lead bank or another financial institute to exercise adequate due diligence, but this does not always happen. So they accept higher leverage in projects, and less promoter equity. About the ability of lenders to recover the loan amount, it is experienced that deficiencies in evaluation can be somewhat compensated by careful post-lending monitoring, including careful documentation and perfection of collateral. The case is presented for drawing learning lessons from lenders' perspective at pre sanction and disbursement stages to ensure effective credit management in the banks.

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Annexure I

Financial Performance

(Amount in crores)

Particulars	*Estimated 31.03.15*	*Projected 31.03.16*	*Projected 31.03.17*	*Projected 31.03.18*	*Projected 31.03.19*
Equity Share capital	17.32	22.34	22.34	22.34	22.34
Profit and Loss Account	0.00	3.22	8.96	16.89	25.68
Tangible Net worth	17.32	25.56	31.30	39.23	48.02
Deferred Tax Liability	0.00	0.00	0.00	0.00	0.00
Adjusted Net worth	17.32	25.56	31.30	39.23	48.02
Net Owned Funds	17.32	25.56	31.30	39.23	48.02
Term Liabilities	28.50	36.80	31.10	25.40	19.70
of which,					
Term Loans	28.50	22.80	17.10	11.40	5.70
Unsecured Loans	0.00	14.00	14.00	14.00	14.00
Net Block	45.60	39.80	34.81	30.52	26.84
Other Non current assets	0.00	1.00	1.00	1.00	6.00
Current Assets	0.22	90.08	95.79	103.55	105.32
of which,					
Inventories	0.00	34.07	36.22	38.55	38.50
Debtors Local	0.00	6.32	7.30	7.79	7.82
Debtors Export	0.00	36.14	41.04	43.78	43.95
Cash & Bank Balance	0.22	3.80	1.48	3.68	5.30
Other Current Assets	0.00	9.75	9.75	9.75	9.75
Current Liabilities	0.00	68.52	69.20	70.44	70.44
of which,					
Creditors	0.00	4.92	5.30	6.54	6.49
Bank Borrowings	0.00	57.00	57.00	57.00	57.00
TL payable in one year	0.00	5.70	5.70	5.70	5.70
Other Liabilities/provisions	0.00	0.90	1.20	1.20	1.25
Net Current Assets (NWC)	0.22	21.56	26.59	33.11	34.88
Gross / Net Sales	0.00	259.82	295.59	315.38	316.61
of which exports	0.00	216.89	246.20	262.68	263.67
Cost of good sold	0.00	186.20	212.26	226.22	227.18
Admn. Selling expenses	0.00	52.23	59.29	63.24	63.53
Depreciation	0.00	5.80	4.99	4.29	3.69
Interest	0.00	10.83	10.57	9.89	9.21
Interest on unsecured loan	0.00	0.00	0.00	0.00	0.00
Net profit before tax	0.00	4.76	8.48	11.74	13.00
Net profit after tax	0.00	3.22	5.74	7.93	8.79
Retained Profit	0.00	3.22	5.74	7.93	8.79

Annexure II

Group Companies Details as on 31.03.2013

(Amount in pcrores)

Name of Group Company	*Activity*	*Banker*	*Exposure*	*Turnover*	*PAT*	*TNW*
Arun Metals Private Limited	Trading of iron and steel	Corporation Bank	34.00	170.97	0.53	10.14
Maha Energy Limited	Biomass Power plant	United Bank of India	49.00	57.47	0.91	19.27
R S Food Products	Rice milling & export	Union Bank of India	43.00	172.09	1.50	10.70
Krishana Vyapaar Pvt Ltd	Investment Co.	No credit exposure	Nil	0.69	0.16	41.45
Maha Investments Pvt Ltd	Investment Co.		Nil	0.50	0.02	1.56
Maha Power Trading Ltd	Trading		Nil	0.08	0.05	1.15
Kishore Agro Pvt Ltd	Flour Mill	Corporation Bank	7.00	28.13	0.05	2.31
Overseas Operations						
Global Nagcorp Limited	Trading of steel scrap	No credit exposure	Nil	185.87	0.80	6.50
Maha Metals DMCC	Trading of Steel scrap		Nil	55.39	1.25	6.11
Maha Industries Pvt Ltd	Commodity trading		Nil	9.28	5.50	11.35
Maha Metal Pte Ltd	Trading of steel scrap and minerals		Nil	19.21	0.28	1.09

Trainers' Note

I. Learning Objectives – Understanding power of 'BBB'

Evaluating three 'Bs' – Behavior, Balance Sheet & projections and Beyond loan file of the borrower are most important factors under credit process in the present click-banking environment. Credit managers are expected to validate the information submitted by the client to take decisions based on the given facts and file for the loan. The case study illustrates the following key learning on effective credit management.

(a) Significance of data validation

(b) Key considerations vetting of project outlay

(c) Important aspects of monitoring like due diligence, governance, related party transactions and end use of funds

(d) Significance of assessing qualitative aspects of loan proposal

II. Teaching Plan

A. Introductory Questions

Effective credit management needs to address critical questions at each stage of loan life cycle such as:

(a) Do promoters have experience and business acumen to run the project and does it reflect in their behavior and documents submitted to the bank?

(b) Whether all promoting directors put together holds majority of shareholdings in the company?

(c) Has Bank preferred to pledge shares of major stakeholders for avoiding possibilities of over-borrowing by promoting directors against the shares of borrowing company?

(d) Whether 3rd party guarantee is proposed from major shareholders to continue their support to the borrowing company in running the business?

(e) Does credit manager observes any related party transactions in the case and whether these are being dealt in accordance to the laid down provisions under law to prevent any diversion/siphoning of funds?

(f) Whether project outlay has been vetted by processing manager of the Bank with respect to necessity of the items considered in the project cost and genuineness of their amount?

(g) Have the sources of promoters contribution and unsecured loans verified independently from their worth report?

(h) What are the prudent measures to be adopted by the appraisal manager to validate balance sheet submitted by the client and other diligence steps to be exercised for quality appraisal?

B. Areas of Discussion

The above introductory questions may be addressed through discussion on following major areas to effect desired learning in the class.

(a) *Promoters Experience:* M/s Ankur Enterprises has been promoted by three entrepreneurs Mr Anil, Mr Bhavik and Mr Chetan who are in business for longer time which is considered to be a strength for credit decision in the case. However, experience analysis reveals that Mr Anil who is 40 years with business experience of 22 years which means

he had started business when he was 18 years old with full time study of BE (instrumentation). Mr Bhavik, a commerce graduate of 50 years experience joined business while he was 17 years age and Mr Chetan who is also commerce graduate commenced business when he was 12 years along with his higher studies. Processing team needs to be satisfied on the promoters' longer years of experience especially in view of their age when they were in the of age of minority and also reportedly pursued their higher studies. The facts submitted in the loan file are to be fully satisfied upon by the processing team before assuming the long experience as a major strength in the case.

(b) *Borrowers' Stake in Business:* Financial stake of promoters in any project indicates degree of interest to run the business by them. One of the richest promoting directors Mr Chetan having net worth of Rs.30.28 crores does not have any share in company's capital and also the worth of other directors/guarantors considered in appraisal is more than two years old. Likely overall performance of the group and associate companies considered to be a strong ground for sanction of loan are of year 2012-13. The same good performance does not necessarily hold good today in year 2015-16 and future projections cannot be extrapolated on the basis of 3 years old performance. Besides, processing team should verify that promoters, guarantors and subscribers to the capital have adequate liquid worth to bring projected contribution towards the project. It is evident from the case that two promoters namely Mr Anil and Mr Bhavik has merely 0.33 percent shareholding and majority part of the capital is owned by group or associate companies which are assumed to be main strength for granting loan. Under such circumstances it is recommended to pledge the shareholding of major shareholders to ensure perpetual stake holding for running the business on the bunch of assumptions considered in proposal. Also pledge of shares shall control over-borrowing by the promoters from market that may adversely impact loan repayment capacity and solvency of the borrower.

(c) *Corporate Guarantee:* Section 185 – It is normal practice to give a corporate guarantee by a holding company to its subsidiary to secure loans to be sanctioned by banks to subsidiary company which is new in the market. In the given case three corporates namely United Deal, Maha Industries and Krishana Vyapaar Pvt. Ltd. owns 99.67 percent share in the borrowing company. Bank should thus endeavor to make these corporate as guarantors to safeguard its interest, but promoters have impressed the bank branch to waive the guarantee of M/s Maha Industries Pvt. Ltd. owning 22.85 percent share in the company, on the ground of being foreign company. However, provisions of section 185 of Companies Act 2013 do not prohibit on such ground, provided that loans made are utilized by the subsidiary company for its principle business activities. Corporate guarantee facilitates lenders to build internal pressures by holding companies on their subsidiaries to ensure end use of funds which can be diluted in the case if holding company is scout free from their moral obligation to support their subsidiaries. The corporate guarantee is recommended to be waived only on the ground that Bharat Bank has also not obtained this which is not a justified reason to deviate from bank norms.

(d) *Related Party Transactions (RPT):* Section 188 – SEBI has close watch on such transactions to avoid any inter firms/companies dealing beyond the prescribed norms to protect interest of various stakeholders. In the extant case, the issue need to be properly addressed by ascertaining reasons of not considering M/s United Deal Pvt. Ltd. as group companies against the fact that 49.67 per cent shareholding of borrowing company is owned by this company. This may be considered as a trigger that borrower is not intending to disclose entities that could be in ambit of related party transactions and these can be used a vehicle to route the transactions with them. If this is the reality the behavior of prospective borrower should not be considered transparent and good from lender perspective. Appraisal managers should therefore, be more vigil to examine related party entities and caution the field functionaries to keep close monitoring on transactions routed through Related Party Transaction (RPT) by stipulating a suitable rider in sanction note for guarding diversion or siphoning off funds.

(e) *Project Outlay:* Term loan assessment is made on the basis of project cost which includes all related items upto commercialization of the conceived project in time. Examining these items from perspective of the reasonableness is an important step in term financing. For example land was acquired for the project in October 2013 for Rs.1.79 cores and development cost is estimated Rs.0.33 crores aggregated amount of Rs.2.12 crores while the same has been overstated by Rs.1.00 crores in both side of project outlay i.e. cost and means of finance the project without infusion of money into business. Similarly the project outlay is understated under the major heads like contingencies, Interest During Construction Period (IDCP) and margin for working capital. The actual net working capita vide projected financial of year 2016 for operationalizing the unit is Rs.21.56 crores, as against margin actually arranged by promoters from long terms sources is Rs.19.24 crores. This may cause either delay in achieving Date of Commencement of Commercial Operations (DCCO) or releasing credit facilities without promoters contribution.

(f) *Beyond File:* Bankers normally emphasize on the appraisal based on loan file which is beautifully created with pictorial and graphic presentation by the prospective client who is engaging some professionals for the purposes. It is therefore, suggested, based on the learning from the case that lenders need to go beyond file for qualitative appraisal and monitoring of account which includes many steps such as:

   (i) *Know Your Loan Arranger:* He is first contact point for borrowers and lenders who introduce the prospective promoter with the bank and make the loan file to be submitted before lenders. Bank should ensure a satisfactory relationship between loan arranger and borrowers, making the loan arranger accountable for any falsification detected in subsequent stages. Bank branches should also maintain records of loan accounts canvassed through loan arrangers and status of the same has to be mentioned in appraisal note.

   (ii) *Validating Balance Sheet:* Bankers obtain balance sheet of the borrowers with assumptions that loan will be served from this document only. But its validation part is found to be missing in letter and spirit. Banks must therefore, develop a system of dialogue with the statutory auditors to get insights of the clients and seek a confirmation from statutory auditors of the borrowers that the financial statement submitted by the clients is audited by them. More particularly when statutory auditors and loan arranger are different firms then it becomes more important to know why the borrower is not being introduced by statutory auditor and instead by loan arranger

   (iii) *Due Diligence Report:* This is an important report that facilitates lender to ascertain status of due diligence to be observed by prospective borrower. Its significance is to be considered at par with obtaining title clearance report for mortgaging a property. Reserve Bank of India has directed banks vide circular RBI/2008-09/183 DBOD No. BC.46/08.12.001/2008-09 dated 19.09.2008 to observe good corporate governance by the borrowing entities through this report in all eligible corporate accounts on each review to ensure that borrower is fully compliant.

(iv) *Realistic Approach:* Appraisal managers need to accept ground realities instead to be over ambitious while discussing financial projections. A few illustrated steps beyond file in this case could have been taken by the bankers to address some vital question like *(a)* Why interest on unsecured loan is taken zero which not realistic? *(b)* Cash and bank balance is abnormally high on 31.03.16, 31.03.18 and 31.03.19, because such a huge balance does not support need to continue working capital limit? *(c)* Five times increase in non current asset from Rs. one crore to Rs. six crores as on 31.03.19?

(g) *Promoters Contribution:* Borrowing company to bring Rs.36.34 crores as margin towards project cost of Rs.64.84 crores by raising capital of Rs.22.34 crores and unsecured loan of Rs.14.00 crores. Promoters' contribution to be infused upfront in the project for its timely completion. The onus of verifying the adequate source of margin and its flow into business lies with appraisal managers. It is evident from the case that term loan was disbursed on 15.10.2014 without ensuring required capital of Rs. 22.34 crores and unsecured loan of Rs.14 crores as estimated financial accepted by the bank reveals that capital of merely Rs. 17.32 crores was raised as of 31.03.2015 and no money was raised from unsecured loans. Besides, this it is essential to ensure from the latest worth report that promoting directors subscribing to the capital and also unsecured lenders giving loan to borrowing company have liquid fund with them. Failing such verification at pre-disbursement stage leads to release of credit facilities without expected margin from borrower. Also at time dilution is observed in core condition of the sanction which happened in this case to modify terms of pledging FDR/NSC and substitute it with mortgage of open plots. The worth report of promoters and guarantors should be of latest dates instead as on 31.03.2013 in the given case to verify available resources with them to run the project.

(h) *Pay off Bank Loans:* Repayment of loan depends on the business cash flow from the project which should be drawn after taking important issues into consideration such as capacity utilization, per unit cost price and sale price etc. in sync with peer competitors and industry. It is observed in most of the business term loans that repayment is fixed stereo type approach to keep loan installment equal i.e. EMI model throughout the project life which is against the standard covenant that project begins with lesser capacity utilization in initial years that generate comparatively lesser revenue as compared to higher sales in subsequent years. Repayment fixed without keeping the said assumption into consideration either causes non serving of interest and principal in time or require modification in the conditions on later stages when loan account comes under stress. It is to be noted from the case that repayment of business term loan should be fixed on ballooning mode and repaying capacity should be further analyzed in different stress scenario to mitigate default risk through various means which may include escrowing revenue of other close group companies, enhance promoters contribution, extend repayment period etc.

(i) *Commercialization of Project:* Implementation schedule is normally considered as one of the formalities without validating the estimated dates given by the promoters. Some of the dates require to be examined based on supporting documentary proof. For example in the present case: *(a)* First disbursement of term loan was made on 15.10.2014 but construction of building and shed and also order to purchase machines accepted to be in July and September 2014 respectively. This should not be accepted unless funds reflected in the current account of borrowing companies that supports captioned dates in this case could be genuine *(b)* term loan is reportedly pending for disbursement as on 31.05.2015 while working capital limit released on 5.3.15 which indicates that project has not completely attained its DCCO but working capital disbursed that led to diversion and siphoning off funds either taking disbursement in personal name of the directors from cash credit account or payment of private dues.

(j) Approval and Clearance: It is important for any lender to release funds toward the project which has obtained necessary approval and clearances from related bodies/ authorities. Company has reportedly sought licenses under regulation and also applied for clearance from MPCB and MSEDCL. Besides obtaining documents of such approvals, it is to be ensured before disbursement that security amount required to be deposited for mandatory approvals also reflect in estimated/projected financials, supported by the flow of such funds through banks' account. It is revealed in many cases that documents submitted by borrowers are fake as these papers were not supported by the flow of money from financial statements and bank accounts.

In view of the above learnings from the case, it can be observed that credit life cycle approach helps to identify various steps and stages in credit processes such as receiving loan application, pre-sanction, sanction, disbursement and review of loan. Proper due diligence and validation of the information from public portals online helps to bring quality and effectiveness in credit management.

Managing Credit when Company's Survival Becomes Questionable: A Case of M/s Smart Textiles Ltd.

Shri Ranjeet Kumar

During 2011-12, almost all textiles companies faced financial crisis due to various reasons including external factors. Financial performances of the companies during the year were dismal. Banks had substantial exposure in the industry and, there was a need to have a different approach in tackling such accounts. M/s Smart Textiles Ltd was one of the companies which went into severe crisis leading to default in repayment to the banks. The present case describes the crisis which the company was facing and trying to overcome the same. A decision by consortium has to be taken about how to handle this situation, keeping in mind the survival prospects of the company as well as maintaining the assets quality of the banks. Further, the consortium of the banks needs to analyze about what can be done to minimize the losses to them if the situation does not improve as envisaged.

Keywords: Asset Quality Management, Consortium, Credit Decisions, Compliance

Background

M/s Smart Textiles Ltd, a Public Limited Company, was established in the year 1988. The primary business of the company is manufacturing of Cotton Yarn, Acrylic Yarn, Garments and Blended Yarn. The units are located at six places in the same city. The company belongs to a reputed group in textiles. The promoters and directors are well experienced and technically qualified to handle the affairs of the company. Brief details of the Management/ Board of Directors of the company are as under:

(a) Mr Smart is a promoter of the company and holding the post of Chairman and Managing Director of the company. He has over 30 years of industry experience. He has experience in yarn manufacturing and is specialized in the field of procurement of cotton which is the main raw material and purchase of capital equipments at corporate level. He is successfully handling the operations of the company in all spheres.

(b) Mr Junior is a promoter of the company and also a director in the company. He is son of Mr Smart (C&MD of the company). He is a management professional. He is looking after the finance matters of the company.

(c) Mr Legal is a Non Executive Independent Director of the company. He is a law graduate in the field of taxation laws. He has substantial administrative experience apart from his own specialized knowledge. He has contributed various articles on Taxation published in the leading news papers and journals.

(d) Mr Consultant is a Non Executive Independent Director of the company. He has over 40 years of experience of Research, Consultancy, HRD and Educational Administration and Industrial Training. He has published over several Research papers in various areas of Management.

Shri Ranjeet Kumar (ranjeetjishnu@gmail.com) Divisional Manager, Canara Bank, Mumbai.

(e) Mr Technical is a Non Executive Independent Director of the company. He is a textile graduate from Mumbai. He has over 30 years of rich experience as a textile consultant in the industry i. Presently, he is associated with the company as a consultant of spinning, dyeing and weaving.

There has not been any change in the directorship of the company in the last one year. Meeting of Board of Directors are scheduled on regular basis. The company has formed three committees of the Board namely, Audit Committee, Investors' Grievance Committee and Remuneration Committee. Meetings of these committees are scheduled on regular basis as per the requirement.

1. Product and Technology

The main products of the company include Cotton Yarn, Acrylic Yarn, Blended Yarn, Dyed Yarn and Garments. The company has installed various imported and indigenous technologies including LK-64 combers, Hydraulic Bale press etc. in their units. All those technologies are fully absorbed. These technologies are helping the company in high production rate enabling shorter payback period. Running cost is comparatively reduced.

The trends in production of the company are given in Exhibit 1.

The process flow chart of production is furnished in Exhibit 2.

2. Marketing Channels

The company has well established marketing and sales channels in both the export and domestic market. In the domestic market, they have three major channels namely,

(a) Agents ----> Brokers -----> Customers

In this channel, agents are appointed by the company to make arrangements for sale and also for receiving the payments on time. These agents have further arrangements of sale to different customers via brokers. Recourse of company is with the agent for both of the purposes.

(b) Distributors ----> Brokers -----> Customers

This kind of arrangement is followed when the payment is arranged by the trader. They can stock the material also and sell to different customers via brokers, if required.

(c) Direct (which includes corporate customers)

The company deals with a few customers especially the corporate buyers directly as well.

For export market, channels being followed are as under:

(i) Agents (Foreign/Indian)

This is the major channel for export marketing. There are Indian as well as foreign agents for this kind of set-up and a combination of them can also exist for export deals where Indian agents have foreign counterparts or vice-versa.

(ii) Direct

The company is dealing with some overseas customers directly as well depending upon the need of services required.

The company does not use advertising as a tool for marketing either in domestic or International market as they do not cater directly to consumers but very focused to knitting industries.

3. Share Holding Pattern

Category	*As on 31.03.2012 (in %)*
(a) Promoters and Promoter's group	45.14
(b) Financial Institutions/ Foreign Institutional Investors/ Banks	0.03
(c) Government	
(d) Corporate Bodies (Other than mentioned above)	30.49
(e) Public and others	24.34
Total	100.00

Around One Percent of total shares are pledged by the Promoters for obtaining personal loans from banks. These loans were utilized to infuse funds in the company.

4. Plant Capacity

The company has six plants in the same city. The plant capacity of the company is as under:

Location	*Description*	*Installed Capacity*
Plant – A	Manufacturing of cotton, blended yarns	105,000 Spindles
Plant – B	Manufacturing of Acrylic Blended Yarns	11,000 Spindles
Plant – C	Manufacturing of cotton, blended yarns	49352 Spindles
Plant – D	Dye House	15 MT/Day
Plant – E	Garment (T Shirts)	2,000 Nos./day Pieces
	Under implementation	
Plant – F	Spinning	25,000 Spindles*

Fifth plant (Project – F) was established with envisaged plant capacity of 40800 spindles. The company has completed installation of 25000 spindles. The remaining spindles are yet to be installed. The project has already started commercial production with 25000 spindles and work is almost completed for remaining 15800 spindles. The incremental cash generation with the remaining 15800 spindles will be more as the Fixed Cost of the project is covered by the already installed 25000 spindles. Completion of the project will add to the bottom line of the company and hence completion of the project is desirable. However due to inordinate delay in the project, the project cost has substantially increased and the company now needs fresh Term Loan of Rs. 16 crores to complete this project.

5. Performance

The company has been performing satisfactorily until a major crisis hit the company during 2011-12. The company's performance was substantially deteriorated and, it incurred heavy cash losses during the year. Financial indicators of the company for the last three years, Auditor's remarks and Cash flow and Funds flow analysis are furnished in Exhibit 3.

Major reasons for this crisis are attributed to the following:

- The government policy on cotton and cotton yarn exports towards the end of 2010 influenced both the cotton and yarn price creating an artificial scarcity of the produce both within and in the global market. Government had put restrictions on cotton yarn exports towards the end of 2010, resulting in Indian players losing their market to other yarn producing nations across the globe during this period. When ban on exports was removed in March 2011, there were huge quantities to be exported with lower demand.
- Due to global recessionary trends, there was further slow-down in demand in both domestic and export markets.
- Anticipation of a spurt in global cotton production further put downward pressure on both cotton and yarn prices.
- The industry is still in the process of clearing high cost of finished goods inventory. Out of 226 listed textile companies in the country, 83 per cent of them have shown poorer results and 127 companies incurred net loss during the first half of 2011-12.
- The interest rates have risen by almost 400 bps over the last 18 months. The high interest cost of almost 8 per cent of the total revenue has further reduced the bottom-line of the Company.

The company's cost of raw material consumed as a percentage of sales has increased from 69 per cent in FY 2010-11 to 84 per cent in 2011-12 Company suffered a cash loss of Rs. 51.82 crores in FY 2011-12 mainly due to high inventory costs resulting from:

- Cotton was procured at all-time high prices in the season between October-March 2010-11.
- Domestic and global cotton and yarn prices fell from record highs since March 2011 due to above mentioned reasons.

The inappropriate investment decisions made by the company during the past had put further liquidity strain on the company's operations.

Moreover, following are few other facts of the textile industry:

The textile industry is the largest job generator after agriculture, employing around 35 million people across various segments and one of the leading providers of foreign exchange in India. The industry accounts for around 14 percent of industrial production and more than 10 percent of the country's total exports.

The global market has adversely affected the working/profitability of the textile industry due to the fluctuations of Indian Rupee *vis-à-vis* US $, steep rise in minimum support price of cotton by Government of India, withdrawal of duty draw back scheme and withdrawal of interest subvention. Sales realizations of yarn exporters have been affected due to recession in USA and Europe. Reduction in global consumers leading to sharp reduction in demand of Textiles also has an impact over the company. The above factors have adversely affected the working of the company. The above problems started right from the year 2008-09 and as deteriorated further in the year 2011-12.

As per the communication sent by the Ministry of Finance dated 14.02.2012, it is stated that "As you may be aware, Textile industry is undergoing stress due to various reasons resulting in negative growth and majority of units reporting net losses. There has been a demand from the industry seeking support from banks by way of restructuring of loans in order to avoid assets turning in to NPAs. The matter has been examined in consultation with RBI. In this regard, RBI has advised the banks can restructure any account, whether standard, substandard or doubtful as also more than once, provided the financial viability is established and there is reasonable certainty of repayment. Certain assets classification benefits are available only if restructuring is done within RBI Framework. However, there is no restriction on banks to restructure outside RBIs framework but in that case asset classification benefits are not available. You are therefore advised to look into each account in the textile sector requiring restructuring and take necessary action to nurture viable accounts within RBI Framework".

As per the minutes of meeting of Ministry of Textiles dated 7.12.2011, Chairman CITI highlighted the crisis in textile industry and need for a restructuring program. He also said that the situation was substantially worse than 2008-09 and out of 226 listed companies, 187 have poorer results compared to the last year and 127 companies have net losses. He pointed out that the Crisis was a result of external reasons - the price volatility in cotton and cotton yarn and a bail out was necessary.

Industry Outlook: (*Source*: CRISIL Research)

It is expected that the cotton and blended yarn industry's net profit to grow by a slower rate of 18.2 per cent compared to the growth rate in income during September 2011 quarter due to a more than- proportionate growth rate in total expenses. Raw material cost , the industry has largest expense head accounting for over 60 per cent of sales, is expected to grow by a sharp 40 per cent as compared to a year ago. This sharp rise is likely to be on account of an increase in production volume and prices of inputs like cotton and man-made fibres. The industry's net margin is expected to contract by 60 basis points to 5.3 per cent as compared to the year-ago quarter. The industry's sales are expected to grow by 26.3 per cent in the year 2011-12 backed by a healthy growth in volume and realization of yarn. Volume is expected to grow at a healthy pace backed by a strong demand from user industries and capacity additions scheduled during the year. Yarn realization is also expected to rise due to an increase in input costs. However, with the growth in expenses expected to outpace the growth in income, the industry's net margin is likely to contract by 120 basis points to four per cent.

6. Capital Market Perception (Rs.)

Face Value	10.00
EPS as at 31.03.2012	(50.12)
Present Share price	65.00
52 Weeks High/Low	112.15/55.00

7. Credit Facilities Availed by the Company

The company is enjoying credit facilities under Consortium arrangement with 14 member banks. The Lead bank is having a share around 29 per cent and the second bank has a share around 19 per cent in the consortium. The remaining 52 per cent share is being shared by 12 Banks with no bank having share exceeding 10 per cent.

Total outstanding position along with overdue is as under:

(Rs in crores)

Facility	*Sanctioned*	*Outstanding*	*Overdue*
Working Capital - Fund Based	156.40	159.52	3.12
Working Capital-Non Fund Based	29.24	28.55	–
Working Capital - Term Loan	86.67	76.26	1.79
Term Loan	349.50	184.21	7.10

There is no outstanding GDRs/ADRs/Convertible Warrants. However, the Company is having an outstanding balance of 2 per cent Unsecured Foreign Currency Convertible Bonds (FCCBs) for the principal amount of Rs 0.85 crore having a maturity period of 5 years. The due date shall fall in the first quarter of 2012-13.

8. Stock Audit Observation

As per Stock audit report, there was shortage of DP to the extent of around Rs. 67 crores as on 31.12.2011. The deficit was mainly due to losses incurred by the company and reduction in the value of the inventory. The inventory holding has gone down due to tight liquidity position of the company.

9. Credit Risk Rating

The credit risk rating of the company has been done by external agency, ICRA. Due to delay/default in several accounts of the company with different banks, the rating awarded to the company is 'D'.

10. Infusion of Funds by Promoters

The Promoters are willing to infuse funds by way of bringing in some part of investment in Subsidiary/Associate Company and also proceeds of sale of unused lands of the company. However, the extent of infusion of funds will depend on its being saleable and market value of land as well as financials of the Subsidiary/Associate Company.

The Company has sought the bank's help in overcoming this crisis.

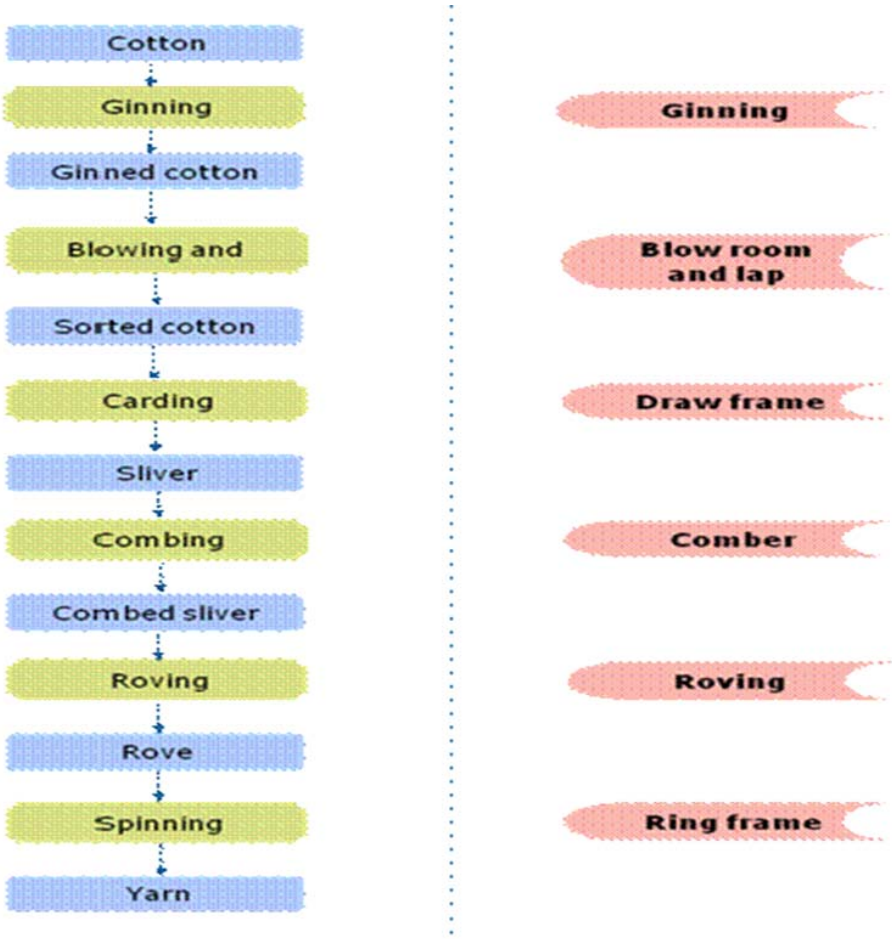
Exhibit 1

Trends in production of the company:

	Unit	*As at 31.03.2012*	*As at 31.03.2011*
(a) Installed Capacity			
Cotton Yarn Spinning	Spindles	1,78,704	1,54,224
Worsted Spinning	Spindles	11,648	11,648
Dyeing Capacity	Tons per day	15	15
(b) Actual Production			
Cotton Yarn	In MT	22,038.64	24,698.53
Acrylic Yarn	In MT	1,086.00	1,483.90
Blended Yarn	In MT	8565.12	6,191.08
Polyester Yarn	In MT	228.00	-
Dyed Yarn	In MT	3970.80	4,569.90
Garments	PCS	3,09,635.00	3,28,156.00
Waste	In MT	10,350.61	9,124.08

Exhibit 2

Process Flow Chart:



Source: CRISIL Research

Exhibit 3

(a) Financial Performance of the Company:

(Rs. in crores)

Particular	*31/03/10*	*31/03/11*	*31/03/12*
Capital	12.66	16.28	16.28
Reserve and Surplus	141.72	159.76	156.30
Intangible Assets / Accumulated Losses	24.68	1.29	79.84
Tangible Net Worth	**129.70**	**174.74**	**92.74**
Long Term Loans from Banks / Fis	110.08	191.66	199.72
Debenture / Bonds/ FCCBs etc.	0.00	0.00	0.00
Capital Employed	**239.78**	**366.40**	**292.46**
Unsecured Loans	**0.00**	**0.00**	**0.00**
Current Assets	179.23	298.14	130.12
Current Liabilities (Current Liabilities)	**300.37**	**256.03**	**354.56**
Bank Borrowing - OD/Cash Credit	238.87	161.26	186.17
Bank Borrowings - Bill Purchased	27.96	0.00	0.00
Net Working Capital	**-121.14**	**42.10**	**-224.44**
Gross Block	437.44	445.55	550.09
Net Block	256.32	237.64	316.79
Investment	151.83	137.88	163.25
Non-Current Assets	9.56	40.60	39.25
Net Sales	**527.68**	**716.06**	**734.67**
of which Exports Sales	161.89	213.91	285.53
Other Income	-21.71	13.00	36.02
Profit Before Depreciation Interest and Tax	37.62	111.08	-7.31
Net Profit Before Tax/(Loss)	(30.69)	35.85	(104.62)
Net Profit after Tax /(Loss)	(22.39)	26.70	(81.41)
Net Profit / Capital Employed (%)	-9.34%	7.29%	-27.84%
Interest	40.01	47.92	67.72
Depreciation	28.31	27.32	29.60
Cash Accruals	5.92	54.02	-51.82
Ratios			
Current Ratio	0.60	1.16	0.37
Total Outside Liability: Tangible Net Worth	3.16	2.56	5.98
Debt Equity Ratio	1.29	1.62	2.18
Profit Before Depreciation Interest and Tax: Sales(%)	7.13%	15.51%	-0.01%
Net Profit Before Tax: Net Sales%	-5.82%	5.01%	-0.14

Particular	*31/03/10*	*31/03/11*	*31/03/12*
Term Debt/ Profit Before Depreciation Interest and Tax	3.63	2.15	-41.71
Profit Before Depreciation Interest and Tax/Interest	0.94	2.32	-0.11
Profit After Tax/Equity (Return on Equity)	-17.26%	15.28%	-87.79%
Inventory Turnover	6.76	4.80	28.22
Debtors velocity	30	37	23
Creditors Velocity	10.24	16.67	26.52
Inventory + Receivables – Bills Discounted/Sales	0.23	0.30	0.11
Cost of Sales to Net Sales	0.90	0.85	1.02

***(b)* Contingent Liabilities:**

(Rs. in crores)

Particular	*31.03.2012*
Claims not acknowledged as debts	3.06
Bank Guarantees/Bonds outstanding in favor of President of India and Others	0.17
Letters of Credit outstanding	--
Bills discounted with Banks against Irrevocable Letter of Credit	58.58
Income Tax demands under appeal	1.44
Demand of Electricity Board	2.55
Subordination letter for not to withdraw the loan from foreign Subsidiary until Negative Equity situation reverses	2.39
Estimated amount of contracts remaining to be executed on Capital Account and not provided for (net of advances)	20.82
Corporate guarantee given on behalf of subsidiary company Oswal F.M. Hammerle Textiles Ltd pursuant to scheme of Corporate Debt Restructuring	82.33
Liability on EPCG License pending export fulfillment	51.02

Besides the above contingent liability, there is disputed Statutory Liability in respect of Income Tax, Wealth Tax, Excise Duty, Service Tax and Sales Tax to the extent of around Rs.7.50 crores and the matter is pending at different level. Against the said amount, the company has deposited just Rs. 2.04 crores.

(c) Auditor's remarks in ABS 2012:

- No provision has been made for investment made in one of the subsidiary companies of Rs.45.01 crores whose net worth is substantially eroded, the company having accumulated losses of Rs. 48.74 crores against share capital of Rs. 50.05 crores. This is at variance with Accounting Standard AS-13 'Accounting for Investment' notified under Companies (Accounting Standards) Rules 2006, resulting in loss for the year being understated and investments and reserve and surplus being overstated by the same amount.
- The company has made investment (of Rs. 91.26 crores) in the equity shares of its other subsidiary company whose net worth is partly eroded. As per Management's view, the investment is long term strategic in nature and the erosion in net worth is due to slump in the textile sector; this being a temporary phenomenon, the net worth will revive in the near future.

- There was no disposal of a substantial part of fixed assets during the year; however during the year, the company has temporarily shut down one of the units. It has no impact on the going concern assumption.
- Sale of Real Estate includes transactions of Rs. 10.47 crores.**
- The company has internal audit system commensurate with the size and nature of its business. It needs further improvement in terms of scope and coverage.
- Amounts due in respect of Term Loan/WCTL from Banks on account of Principal and Interest aggregating Rs. 64.20 crores were delayed and either paid during the financial year or subsequently. As explained by the management, the delays are attributed due to current year losses on the account of the fluctuations in cotton fibre and yarn prices.
- In respect of other amounts due to Banks aggregating to Rs. 6.81 crores, the payments have been delayed from 1 day to 120 days and are outstanding as on date.
- The funds raised by the company on short term basis have been applied for long term investment to the extent of Rs. 181.81 crores.

** (It is observed from the Note of ABS 2012, that the company has sold Land and Building of Gross Block of Rs. 13.27 crores during 2011-12. .Charge in ROC is created in favor of consortium banks on all Fixed assets of the Company)

(d) Cash Flow Analysis:

(Rs. in crores)

	31.03.2011	*31.03.2012*
Net Cash Flow from Operating Activities	16.34	176.53
Net Cash Flow from Investing Activities	-25.85	-98.49
Net Cash Flow from Financing Activities	20.43	-95.60
Total Increase/(Decrease) in Cash	10.92	-17.56
Opening Cash and Bank Balance	11.48	22.39
Closing Cash and Bank Balance	22.40	4.83

(e) Funds Flow Analysis:

(Rs. in crore)

	Audited 31/03/11	*Audited 31/03/12*
Long Term Sources	210.96	29.00
Long Term Uses	47.71	295.55
LT Surplus (+)/Deficit (-)	163.25	-266.55
Short term Sources	33.26	266.55
Short Term Uses	196.51	0.00
ST Surplus (+)/Defict (-)	-163.25	266.55

References

1. Annual Reports (Published) of the Company for 2010, 2011 and 2012.
2. CRISIL Research
3. www.texmin.nic.in

Trainer's Note

Case - M/s Smart Textiles Ltd

Objective: To learn how to handle a large borrowal account under consortium when a company is facing severe liquidity and financial difficulties as well as there is risk of dilution the existing securities provided to the banks for credit limits.

Sub: Credit Management.

Resources: Copy of Case – M/s Smart Textiles Ltd, White Board, Marker Pen, Calculator etc.

Methodology: The participants should be provided the case one day before the class, they should work on it either individually or in groups and then the case should be discussed in the class.

Session Time: 90 Minutes

Session Plan:

Time	*Trainer*	*Method*	*Participants*	*Learning Point*
15 Min	Background and Present position of the company and its financial indicators.	Discussion and Exercise on financial indicators	To respond and participate in discussion and interpretation of various financial indicators.	Understanding the concept of various financial ratios and their interpretation.
15 Min	Analyzing the causes of the present situation	Discussion	To scrutinize the causes of the deterioration in financials/working of the company and discuss.	Differentiating the internal and external factors which may adversely affect the financials/working of the company.
20 Min	Company's requirement in the present situation.	Discussion and Exercise on various options.	To work out the company's requirement and present their views on different aspects.	Evaluating the requirement of the company in recovering the crisis.
10 Min	Issues with banks	Discussion	To find out any features, which might have affected the quality of bank's assets.	Listing the issues with the banks. How to keep follow up to avoid any such situation in future.

Time	*Trainer*	*Method*	*Participants*	*Learning Point*
15 Min	What banks should do	Discussion	Based on company's requirement (worked out as above), state views on how to help the company and also maintain the good assets quality.	Various options available with the banks in handling such situation and maintaining the good assets quality. To understand the extent up to which the bank can go in handling stressed assets.
15 Min	What the Company/ Promoters/Top Management officials should do.	Discussion	To share views on strategy, which company/Promoters/ Top Management officials should adopt to come out of the crisis.	To understand the terms and conditions which the banks should stipulate for compliance by the company/ promoters.

Note for the Learning Points

1. Understanding the concept of various financial ratios and their interpretation

   (a) Definition of financial terms and ratios like Tangible Net Worth, Net Working Capital, Current Ratio, PBDIT (Profit before depreciation, interest and tax), PBDIT to Sales, Net Profit Margin, Total Outside Liability to Tangible Net Worth, Debt Equity Ratio, Contingent Liability etc.

   (b) Notice the movement of Tangible Net worth to find out whether there are changes in capital, reserve and surplus, intangible assets etc.

   (c) Observe the movement of NWC to find out whether the promoters have brought in the required working capital margin during the year.

   (d) Changes in Leverage ratios like Debt Equity Ratio, TOL:TNW, PBDIT to sales and their effects.

2. Differentiating the internal and external factors which may adversely affect the financials/working of the company.

   (a) The financials of the company have deteriorated substantially. However, there is no single reason for this deterioration. Internal as well as External factors are responsible for this situation of the company. There was lack of foresight on part of promoters/top management officials even though the company has long standing and promoter/directors are veteran in the field. The external factors like Government policies, sharp fluctuation in prices of raw material, etc. have contributed significantly in ruining the working/financials of the company.

   (b) Lack of adequate mitigation measures for external adverse factors was not in place.

   (c) The new plant was established when the situation was not so favorable, Further, the plant was not completed in time which resulted in substantial escalation of cost of the project.

(d) Prudent decisions were not taken while making investment in the subsidiary companies.

(e) There was diversion of funds and as per Auditor's remarks the funds raised on short term bases were utilized for long term investments.

3. Evaluating the requirement of the company in recovering the crisis.

(a) The shortfall in Drawing Power has been estimated in the Stock Audit report to the extent of Rs. 67.00 crores. An independent calculation of Drawing Power needs to be done. It can be compared with the Drawing Power based on the Audited Balance Sheet.

(b) The margin on inventory (Raw materials, Work in Progress, Finished goods, Goods for export), Debtors (Domestic, Export) should be analyzed and it can be modified to reduce the shortfall in Drawing Power.

(c) The company will need Working Capital Term Loan to the extent of shortfall as derived above.

(d) The company needs additional fresh Term Loan to complete the Project-F which is under implementation. The Project is already working with around 25000 spindles and the remaining 15800 spindles are to be completed. The fixed cost for the remaining spindles has also already been done.

(e) The company needs to repay the overdue liabilities with the banks to keep its account regular. In case the company, with its present cash flow together with proposed infusion of funds by promoters, is not able to serve the present liability then its credit facilities need to be restructured.

(f) The company has outstanding Unsecured Foreign Currency Convertible Bonds of USD 8.5 Million which shall fall due in the first quarter of 2012-13. The company should be prepared to repay the bond liability in case the investor insists for the same.

4. Listing the issues with the banks. How to keep follow up to avoid any such situation in future.

(a) Banks can raise the following issues which need to be resolved amicably:

- In Audited Balance Sheet, it is observed by the auditors that the company has sold part of its Fixed assets including land and building. Whether the necessary permission of consortium banks was obtained as charge on entire assets of the company was created. The proceeds of the assets sold should be in tune with the market value of the property. The proceeds should have been actually brought in the system and bank's liability should have been reduced to that extent. The utilization should be confirmed by the statutory auditors. If the security of the banks have been diluted, the same should be made good.
- The investment in the subsidiary company doesn't seem to be a prudent decision considering the financial position of the company and its subsidiary. The time line under which the company shall be able to bring back the investment, needs to be drawn.
- Securities (Prime and Collateral) available with the consortium banks should be perfected.

– Funds flow analysis indicates that there was diversion of funds. The promoters of the company should explain for the same. They should present a concrete plan along with the time line regarding bringing back the diverted funds and also infusion of long term funds to ease the liquidity.

5. Various options available with the banks in handling such situation and maintaining the assets quality. To understand the extent up to which bank can go in handling stressed assets.

   (a) Banks need to verify whether the company should abandon the installation of the remaining spindles or complete the project-F which is under implementation. In the above analysis, the effect of completion of project and additional cash in-flow to be verified with the repayment liability of the additional Term Loan. Further, whether the Promoters will be able to infuse additional funds for margin.

   (b) The company has incurred substantial loss and is facing very tight liquidity. The company is not able to serve its existing repayment liability to the bank.

   (c) Banks can evaluate the following different options :

   – If promoters are able to infuse sufficient funds in the system so that the repayment liability in all Term Loans, the banks can sanction Working Capital Term Loan for the shortfall in Drawing Power and continue the remaining limits. With passage of time as the company built up the current assets, the limits can be suitably enhanced. In continuing the limits, a decision can be taken regarding reduction in Rate of Interest/Charges so that the company's burden can be reduced to certain extent.

   – Restructure the limits of the company by giving moratorium for Term Loans and elongating the repayment period. Working Capital Term Loan for shortfall in Drawing Power can be sanctioned with a suitable moratorium period. Further, concession in Rate of Interest and other charges can be considered so that the company is able to repay it liability in time. Since there are 14 banks in the consortium, the case needs to be referred to CDR.

6. To understand the condition which the banks should stipulate for compliance by the company/promoters.

   (a) The company needs to take professional help in managing its day to day working and bringing more efficiency. A banker from consortium banks can be included on board of directors so that the same can have beforehand information about any decision in policy changes.

   (b) Required infusion of funds should be quantified. Source of infusion of funds by promoters should be critically analyzed to ensure that funds are actually infused in the system.

   (c) Inspection of stock/securities by consortium banks at periodic interval to be strengthened to avoid any dilution in securities.

Suggested Readings

1. Wild, Subramanyam and Halsey, Tata McGraw-Hill, Financial Statement Analysis.

2. Mukherjee, Snow White Publication, Credit Appraisal, Risk analysis and Decision Making.

Credit Monitoring and Portfolio Supervision: Key Towards Effective Credit Management

Shri Mainak Banerjee

Various Recovery mechanisms are available with Banks. Looking at practical difficulties in recovery, however, it is a better option to identify difficult accounts before their slippage itself and take correct measures.

Introduction of several credit monitoring mechanisms by Reserve Bank of India points to the importance of this activity.

This Case Study attempts to create awareness as well as a sense of alertness within the Participants towards monitoring of their existing and prospective credit portfolio. This Case Study is aimed for Credit Officers and Branch Heads, even though it may be extended for Officers in Administrative Offices looking after Portfolio Supervision as well.

Keywords: Credit Monitoring, Portfolio Supervision, Credit Management

The Letters

Ms Jhanhavi Malakar couldn't believe her eyes. For more than 15 years, she has served 'Royal Services Bank' (RSB) with full dedication and now Ms Jhanvi is being held responsible for multiple accounts turning into NPA. She looked at the letters again and remembered the days of joining her Paharganj Branch.

The Branch

Ms Jhanhavi Malakar is an MBA who joined RSB as a Probationary Officer. Initially she was working in Branch Operations and Customer Service Department. Later she served a tenure in the Field Administration Office of the Bank. Looking at her excellent performance, the Higher Management of the Bank decided to deploy her as a Branch Head. Paharganj Branch is located around 40 km away from Agra. Ms Jhanhavi was appointed Branch Head of this Branch. It was a loss making branch.

Some key figures of the Branch are provided in Annexure I.

The Manager

Immediately upon taking charge of the Branch towards the end of 2014, Ms Jhanhavi analyzed its performance and decided that to increase the profitability to make the branch profitable she would have to resort to increasing MSME and Corporate Advances.

Shri Mainak Banerjee (Mainak.Banerjee@bankofbaroda.com) Chief Manager and Learning Head, Bank of Baroda, Guwahati.

There was no large corporate unit nearby. There was, however, a factory of M/s Goldilocks Ice Cream Pvt. Ltd. in the vicinity. When Ms Jhanhavi approached the unit, she was informed that their Corporate Office is located in Agra and Accounts Department is looking after Banking arrangements of the unit.

The Clientele

In addition to continuing Retail financing, Ms Jhanhavi explored the nearby areas for quality SME borrowers. She was able to identify some potential clients as mentioned below.

(a) Mr Anandilal Kashyap, Proprietor of M/s Cure All Diagnostics for financing his existing business of a local diagnostic centre.

(b) Mrs Kalyani Arumugam, Partner of M/s Suhana Saree Stores - a local garment trading unit.

(c) Mr Sarvesh Gidwani, Director of M/s Siddharang Industries Pvt Ltd. - to set up a unit for manufacturing RCC Hume Pipes. It was a new project.

A brief description of the units is mentioned in Annexure II.

Results

Paharganj Branch became profitable within 2 years. Subsequent upon her promotion to a higher grade, Ms Jhanhavi got transferred to another Branch near Raipur.

Aftershock

Now, Ms Jhanhavi noted with shock, all three accounts had slipped into NPA category. While recovery measures were underway – she was held responsible for the possible loss of the Bank.

Efforts

Ms Jhanhavi sought permission from the Bank's Higher Authorities to examine the cases. The same was allowed.

She went back to Paharganj Branch and started looking at the papers and verified the accounts.

Few observations by Ms Jhanhavi are mentioned in Annexure III.

Representation

Ms Jhanhavi put up her submission to the Higher Authorities of the Bank.

Assignment

You are required to answer the following questions

(a) To what extent Ms Jhanhavi Malakar may be considered responsible for the A/cs turning into NPA?

(b) What actions would you take to ensure that similar events do not occur in future?

Annexure I

Branch Profile of Paharganj Branch

The branch is located in an urban residential area. It was opened a couple of years back but was struggling to turn profitable.

The Branch had three officers apart from the Branch Head, along with four clerical staff and two sub staff.

Few financial indicators of the branch are as under :

(Rs. in millions)

Parameter	*31.03.2013*	*31.03.2014*	*30.09.2014*
Demand Deposit	87	145	190
Savings Deposit	435	540	830
Term Deposit	715	1475	1800
Msme Advance	3	25	36
Housing Loan	160	510	625
Education Loan	3	4	5
Auto Loan	7	20	50
Int. Earned	18	40	55
Int. Paid	45	110	125
Other Income	8	22	8
Staff Exp.	6	7	8
Profit/(Loss)	(25)	(55)	(70)

Annexure II

Few Customers who were sanctioned Credit Facilities by Ms Jhanhavi Malakar

Ms Jhanhavi used to assess each borrower over a period of time. She used to comply with various pre sanction appraisal norms as stipulated by the Bank. Even though she explored the market for various customers, after interview only a few were sanctioned credit facilities from the Bank.

Following is brief profile of some borrower units which were sanctioned credit facilities during the tenure of Ms Jhanhavi Malakar at Paharganj Branch of Royal Services Bank.

M/s Cure All Diagnostics, Proprietor Mr Anandilal Kashyap

The firm was running a diagnostic centre around 5 kms away from Paharganj Branch for the past 3 years. Mr Kashyap wanted to expand his business and, hence, approached the bank for working capital limits.

Brief financials of the firm are as under :

Balance Sheet for the Current Year

(Rs. in Millions)

Liabilities	*Amt*	*Assets*	*Amt*
Proprietors' Capital	200.00	Net Block	263.90
Surplus in P/L A/c	5.10	Sundry Debtors	10.93
Working Capital from Bank	15.00		
Unsecured Loan from Friends & Relatives	97.56	Stock in Trade	45.48
Sundry Creditors	8.17		
Other Liabilities	0.28	Cash & Bank Balance	3.65
Provision for Taxation	1.85	Other Current Assets	4.00
Total	327.96	Total	327.96

Projected Balance Sheet for the Next Year

(Rs. in Millions)

Liabilities	*Amt*	*Assets*	*Amt*
Proprietors' Capital	200.00	Net Block	205.01
Surplus in P/L A/c	10.52	Sundry Debtors	15.23
Working Capital from Bank	15.00		
Unsecured Loan from Friends & Relatives	58.56	Stock in Trade	55.41
Sundry Creditors	6.89		
Other Liabilities	0.30	Cash & Bank Balance	11.00
Provision for Taxation	15.91	Other Current Assets	20.53
Total	307.18	Total	307.18

Profit & Loss Statement for the two years

(Rs. in millions)

Particulars	*Current Year*	*Next Year*
Sales	97.85	141.09
Operating Costs	71.46	92.85
Administrative &Selling Expenses	20.89	33.05
Financial Expenses	1.12	1.49
Tax Expenses	1.98	5.68
Net profit	2.4	8.02

M/s Suhana Saree Stores

Mr Ramesh Arumugam and his wife Mrs. Kalyani Arumugam have been running the shop for the past 35 years. The shop is having a loyal customer-base. Initially it was a proprietorship firm, and got converted into Partnership 10 years back. Limits were enhanced after one year.

Brief financials of the firm were as under:

Balance Sheet for the Current Year

(Rs. in lacs)

Liabilities	*Amt*	*Assets*	*Amt*
Partners' Capital	159.09	Net Block	49.89
Surplus in P/L A/c	31.06	Sundry Debtors	168.49
Working Capital from Bank	360.00	Stock in Trade	403.50
Car Loan from another Bank	23.76	Cash & Bank Balance	12.00
Sundry Creditors	82.40		
Other Current Liabilities	15.54	Other Current Assets	37.97
Total	671.85	Total	671.85

Balance Sheet for the Next Year

(Rs. in lacs)

Liabilities	Amt	Assets	Amt
Partners' Capital	200.00	Net Block	34.34
Surplus in P/L A/c	37.79	Sundry Debtors	190.00
Working Capital from Bank	410.00	Stock in Trade	565.00
Sundry Creditors	187.50	Cash & Bank Balance	4.26
Other Current Liabilities	6.96	Other Current Assets	48.65
Total	842.25	Total	842.25

Profit & Loss Statement for the two years

(Rs. in lacs)

Particulars	*Current Year*	*Next Year*
Sales	2050.00	2548.06
Operating Costs	1918.04	2385.51
Administrative &Selling Expenses	70.00	81.37
Financial Expenses	30.00	33.00
Tax Expenses	8.54	9.64
Net profit	23.42	38.54

M/s Siddharang Industries Pvt Ltd.

The Promoters of the company were originally engaged in manufacturing of paver blocks, bricks, slabs, manhole cover, and various other concrete products. The existing business units were profitable and the promoters decided to venture out in the area of RCC Hume pipe manufacturing.

Paharganj Branch, under the leadership of Ms Jhanhavi Malakar had set itself out for excellent service and, hence, the Directors of the company approached the Bank with the Project details as under:

(Rs. in millions)

Sl No.	*Project Cost Component*	*Amount*	*Bank Loan Amount*	*Promoters' Contribution*
1.	Land Development	3.00	--	3.00
2.	Civil Structure	103.79	41.25	62.54
3.	Machinery, Electricity equipments etc.	202.50	155.00	47.50
4.	Other Fixed Assets	2.64	1.90	0.74
5.	Pre-operative and financial Expenses	1.50	--	1.50
	Total	313.43	198.15	115.28

Promoters' contribution was proposed to be brought in by way of internal accruals from their existing businesses.

Financials of existing businesses of the promoters were satisfactory. Ms Jhanhavi Malakar had carried out a Techno Economic Viability Study from a Lenders' Independent Engineer who certified that the Project is viable.

Annexure III

Few Irregularities in the three A/cs as observed by Ms Jhanhavi Malakar

M/s Cure All Diagnostics, Proprietor Mr Anandilal Kashyap:

1. Regular cash deposits in the A/c to prevent future irregularity, if any.
2. Submission of Monthly Stock & Debtors statements were irregular and delayed for more than 4 months on two occasions.
3. During one financial year, 17 cheques were returned for non availability of funds in the A/c.
4. Rs. 10000 was being withdrawn from the cash credit account on a weekly basis towards miscellaneous expenditure by the Proprietor.
5. Same medicines as well as other materials in the diagnostic centre were shown to be part of the stock statement continuously for more than 8 months.

During an inspection, the Bank's hypothecation board could not be found in the premises.

M/s Suhana Saree Stores:

1. As per reports of the Stock Auditor, there was wide variance in Drawing Power as per monthly Stock and Debtors statement submitted to the Bank and as per actual stock/ debtors observed in the firm.
2. The firm used to submit financial statements after completion of 8 months of the financial year.
3. Manager of the shop, who was working there for the past 14 years, resigned.
4. Rs. 10 Million from the cash credit A/c was paid to M/s Chanakya Construction Pvt. Ltd. There were other remittances to car dealers, consumer appliance suppliers etc.
5. Stocks were insured to the extent of Rs. 6 crores. The firm started exporting sarees to Germany and a significant level of stock was shown to be on transit.
6. Auditors of the firm were changed twice during three financial years.
7. Some Debtors of the firm, whose details were provided to the Bank, declined to have any relationship with the Partners when contacted. Their invoices had not been checked during inspection.

M/s Siddharang Industries Pvt. Ltd.:

1. Disbursement was being availed on a weekly basis while inspection to the factory site used to be conducted on a bi-monthly basis.
2. Implementation schedule of the project was changed multiple times.
3. Original Promoters reduced their stake in the business and new directors were inducted.
4. The company's auditor used to submit a statement of cost incurred in the project as well as means of financing the same on a quarterly basis. In one of the reports, it was mentioned that term loan for machinery has been disbursed before the drawdown for civil structure was completed.
5. The Promoters availed Rs. 30 Million from the Bank towards constructing the civil structure and Rs. 165 Million for procurement of Machinery, Electricity equipments etc. Interchanges in term loan was permitted.
6. The Company was sometimes unable to submit original bills for which funds were availed from the Bank.

Annexure IV

Illustrative list of signs of stress for categorising an account as SMA-0

1. Delay of 90 days or more in *(a)* submission of stock statement/other stipulated operating control statements or *(b)* credit monitoring or financial statements or *(c)* non-renewal of facilities based on audited financials.
2. Actual sales/operating profits falling short of projections accepted for loan sanction by 40 per cent or more; or a single event of non-cooperation/prevention from conduct of stock audits by banks; or reduction of Drawing Power (DP) by 20 per cent or more after a stock audit; or evidence of diversion of funds for unapproved purpose; or drop in internal risk rating by 2 or more notches in a single review.
3. Return of 3 or more cheques (or electronic debit instructions) issued by borrowers in 30 days on grounds of non-availability of balance/DP in the account or return of 3 or more bills/cheques discounted or sent under collection by the borrower.
4. Devolvement of Deferred Payment Guarantee (DPG) instalments or Letters of Credit (LCs) or invocation of Bank Guarantees (BGs) and its non-payment within 30 days.
5. Third request for extension of time either for creation or perfection of securities as against time specified in original sanction terms or for compliance with any other terms and conditions of sanction.
6. Increase in frequency of overdrafts in current accounts.
7. The borrower reporting stress in the business and financials.
8. Promoter(s) pledging/selling their shares in the borrower company due to financial stress.

Annexure V

Some Early Warning Signals which should alert the bank officials about some wrongdoings in the loan accounts which may turn out to be fraudulent

1. Default in payment to the banks/sundry debtors and other statutory bodies, etc., bouncing of the high value cheques
2. Raid by Income tax/sales tax/central excise duty officials
3. Frequent change in the scope of the project to be undertaken by the borrower
4. Under insured or over insured inventory
5. Invoices devoid of TAN and other details
6. Dispute on title of the collateral securities
7. Costing of the project which is in wide variance with standard cost of installation of the project
8. Funds coming from other banks to liquidate the outstanding loan amount
9. Foreign bills remaining outstanding for a long time and tendency for bills to remain overdue
10. Onerous clause in issue of BG/LC/standby letters of credit
11. In merchanting trade, import leg not revealed to the bank
12. Request received from the borrower to postpone the inspection of the godown for flimsy reasons
13. Delay observed in payment of outstanding dues
14. Financing the unit far away from the branch
15. Claims not acknowledged as debt high
16. Frequent invocation of BGs and devolvement of LCs
17. Funding of the interest by sanctioning additional facilities
18. Same collateral charged to a number of lenders
19. Concealment of certain vital documents like master agreement, insurance coverage
20. Floating front/associate companies by investing borrowed money
21. Reduction in the stake of promoter/director
22. Resignation of the key personnel and frequent changes in the management
23. Substantial increase in unbilled revenue year after year.
24. Large number of transactions with inter-connected companies and large outstanding from such companies.
25. Significant movements in inventory, disproportionately higher than the growth in turnover.
26. Significant movements in receivables, disproportionately higher than the growth in turnover and/or increase in ageing of the receivables.
27. Disproportionate increase in other current assets.
28. Significant increase in working capital borrowing as percentage of turnover.

29. Critical issues highlighted in the stock audit report.
30. Increase in Fixed Assets, without corresponding increase in turnover (when project is implemented).
31. Increase in borrowings, despite huge cash and cash equivalents in the borrower's balance sheet.
32. Liabilities appearing in ROC search report, not reported by the borrower in its annual report.
33. Substantial related party transactions.
34. Material discrepancies in the annual report.
35. Significant inconsistencies within the annual report (between various sections).
36. Poor disclosure of materially adverse information and no qualification by the statutory auditors.
37. Frequent change in accounting period and/or accounting policies.
38. Frequent request for general purpose loans.
39. Movement of an account from one bank to another.
40. Frequent ad hoc sanctions.
41. Not routing of sales proceeds through bank
42. LCs issued for local trade/related party transactions
43. High value RTGS payment to unrelated parties.
44. Heavy cash withdrawal in loan accounts.
45. Non submission of original bills.

Annexure VI

Some Credit Monitoring Tools

1. Credit information report from commercial bureaus as well as banks.
2. Pre as well as post sanction inspection report of Office of the Borrower, site of Business, Residence of Borrower & Guarantor, etc.
3. Inspection as well as verification of primary and collateral securities.
4. Document verification.
5. Credit Disbursement status and comparison with sanction stipulations.
6. Monthly Control Returns submitted by the Branch to the Administrative Office.
7. CRILC as well as ECGC database.
8. CERSAI Verification – pre as well as post sanction stages.
9. Stock statement and book debt statement
10. Periodic Search Report from ROC
11. Quarterly Returns as well as operating statement of the Borrower – comparison with expected drawdown schedule.
12. Certified statement of cost of the project and means of finance – estimated and actual.
13. Audit Reports – of Branch – by Concurrent/Internal Statutory/RBI Audit.
14. Reviewing the A/c as well as its financial statements at periodic intervals.
15. Legal Audit as per RBI norMs
16. Periodical Inspection report of stock, books/records of inventories of the borrower's unit, assets/securities etc.
17. Statement of borrowal accounts at regular intervals.
18. Stress accounts/SMA Report/List of potential NPA.
19. Credit & Stock Audit Reports.
20. The above is an illustrative list only.

Trainers' Note

Credit Monitoring and Portfolio Supervision: Key towards Effective Credit Management

1. *Learning Objectives*

Credit Monitoring Tools and Techniques at the Post sanction Stage for SME A/cs.

2. *Teaching Plan*

The Case Study encourages learning through discussion, hands on approach, as well as presentation etc. by the Participants. A gradual release of details is expected to make the learning process more immersive.

Multiple sessions, up to five, may be utilized towards administering this Case Study.

Even though the focus is on SME segment in this case, several mechanisms described herein may be applied to Retail as well as Corporate advances. Scope of the same depends on the audience as well as deliverables decided by the Trainer.

A structured as detailed Training Plan is suggested below. The Trainer may made necessary modifications at the time of delivering the session.

(a) The Trainer may start the session by enquiring various reasons for increasing NPA from the Participants.

(b) Participants may be asked what is better – to resolve the difficulties once the A/c has turned NPA, or to prevent the A/c from becoming NPA? A Debate may be encouraged among various Participants for 5 to 10 minutes.

(c) The conclusion should be on prevention of slippages as the better option. The Trainer may cite various guidelines from Regulator towards the importance of Credit Monitoring.

(d) Next the Case may be administered. Branch Profile/figures of Participants may be discussed for 5 to 10 minutes.

(e) Conclusion from the above discussion should be that increased credit exposure is a must for enhancing Branch profitability. Annexure I may be distributed among the Participants at this point of time.

(f) A discussion may be carried out on the type of advances which may yield maximum benefit for a Branch. Discussion among Participants is encouraged for 5 to 10 minutes.

(g) Importance of the SME segment may be mentioned in this case, since Retail advances work on razor thin margin due to intense competition in the market. Large Corporate Borrowers with good credit rating by external agencies, on the other hand, are in a position to negotiate well with Banks and extract maximum benefits.

(h) Subsequently, the Trainer may discuss the activities conducted prior to sanction.

Length of this segment depends on the Trainer's discretion. It is possible to allot a full session on this topic by dividing the Participants in various groups and brainstorming on this area. Or the Trainer may allot half a session towards discussing the key issues.

The following areas may be highlighted during this discussion :

KYC & Credit Report	Inspection	Management	Technology
Marketability	Background of the Borrower	Products or Services	Valuation/ Assets to be created
Licenses and Permits	Financial Parameters	Business Model/ Operating Cycle	Legal Opinion

The above list is illustrative and not exhaustive.

ii. In case the Trainer decides to extend this segment to a full session, the Candidates may be encouraged to prepare a checklist for the pre-sanction stage.

iii. There's scope – among the details provided in Annexure II – to discuss financial analysis part as well if the Trainer decides so. Different due diligence measures applicable for various constituents may also be incorporated within the additional session.

(i) Once this session is over, Annexure II may be distributed among the Participants. Multiple groups may be formed and they may be asked to prepare suggestive methods towards proper monitoring measures that would have ensured that the Accounts continue to remain in standard category. While the Participants may work in groups, the Trainer should keep a note on the direction of discussion and guide the teams from time to time.

(j) Once this assignment is complete, Annexure III may be distributed among the Participants.

It may be explained that an A/c, even after meticulous due diligence before sanction, may turn into NPA for various reasons - some of which may be beyond the control of the Borrower. A successful Credit Monitoring mechanism aims to prevent such a scenario.

Annexure III contains some illustrations wherein a proper Credit Monitoring mechanism is likely to help the Banks towards prevention of slippages at an early stage. The Trainer may discuss several other scenarios. Effort should be towards drawing response from the Participants on possible implications of the illustrations mentioned.

After discussion, concept of 'Special Mention Accounts' (SMA) is to be introduced to the Participants and 3 sub categories are to be discussed.

(k) Annexure IV, which contains illustrative list of signs of stress for categorising an account as SMA-0 as published by RBI, is to be distributed among the Participants at this juncture. Discussion on the Parameters as well as prevention of frauds may be carried out.

(l) Annexure V is an extract from RBI's Framework for dealing with loan frauds. The same may be distributed among the Participants subsequently.

(m) Parameters therein may be discussed one by one. Some of them have already been included in Annexure III.

(n) Candidates may now be asked to complete the assignment as mentioned in the Case Study in groups.

(o) They may be asked to give presentations- each group focusing on one area and presenting for five minutes.

(p) The job role of an administrative office may also be highlighted. Several banks have now instituted a separate Credit Monitoring Cell whose job role is to continuously monitor the existing credit portfolio.

Concept of portfolio supervision in a bank wise scenario may be highlighted. A Branch may not be aware that the overall exposure of the bank in a particular industry/segment is showing an increasing trend. The Administrative Office, on the other hand, may track advances growth in a particular industry/segment/geographic region and initiate appropriate measures.

(q) Finally Annexure VI as sample Credit Monitoring Tools is to be distributed among the Participants and may be deliberated upon.

Different terminologies as well as their implications, which are, yet to be covered, may be explained by the Trainer – in summarized form or in detail – depending on scope of the session. It is possible to dedicate one entire session to this segment.

It is to be concluded that Credit Monitoring is a continuous process encompassing the entire Credit Lifecycle.

Suggested Reading

(a) RBI Guidelines on "Early Recognition of Financial Distress, Prompt Steps for Resolution and Fair Recovery for Lenders: Framework for Revitalising Distressed Assets in the Economy."

(b) RBI Guidelines on "Framework for dealing with loan frauds."

(c) Fraud Risk Management in Banks: The Do's and Don'ts – Key Note Address delivered by Shri S. S. Mundra, Deputy Governor, Reserve Bank of India at Seminar on Financial Crimes Management arranged by CAFRAL on January 30, 2017 in Mumbai.

(d) Asset Quality of Indian Banks: Way Forward Key note address delivered by Shri N. S. Vishwanathan, Deputy Governor, Reserve Bank of India at National Conference of ASSOCHAM on "Risk Management: Key to Asset Quality" in New Delhi on August 30, 2016.

(e) Problem Loan Management & MSME Financing- Valedictory Speech delivered by Shri R. Gandhi, Deputy Governor, Reserve Bank of India on January 30, 2015 at a Workshop organised by CRISIL on "Credit Risk and Problem Loan Management" at Goa.

Early Warning Signals: Catch them Early, Catch them Young

Shri Vineet Kumar Jain

The rise Non-Performing Assets (NPAs) is a major concern for any bank. Maintaining the asset quality and recovering overdues is a great challenge. The largest contributor in terms of amount of NPAs is the wholesale segment. Most of the large borrowers are turning into NPAs due to genuine reasons but some of them are defaulting willfully. In each cases, there are some early warning signals. These are called, 'early warning signals' because they appear well before any account turns into NPA. This case helps us to understand that early warning signals in loan accounts should be integrated with the credit monitoring process in the bank so that it becomes a continuous activity and also acts as a trigger for identification of any possible credit impairment in the loan accounts. We find that early warning signals can be used as an important source of information for detecting them at the right moment which may prevent slippage and/or can reduce the losses for the bank. Through this case, we can understand the importance of various early warning signals and using these signals for corrective action plan. It also shows that asset quality can be improved significantly by using these signals in our credit monitoring mechanism.

Keywords : Non Performing Assets, Asset Quality Management, Early Warning Signals, Credit Monitoring

Introduction

The Annual General Meeting of ABC Bank Ltd was being held and discussion on final results and future course of action of the bank was going on. Mr Anupam Kapoor, MD & CEO of ABC Bank Ltd was attending to the queries of shareholders. While replying to the query related to credit quality, he committed that the Net Non Performing Assets of the Bank, as on 31st March of the current financial year, would not cross the Net Non Performing Assets level of the previous financial year. This statement was highly appreciated by the shareholders as well as media. All news channels covered this statement in their prime time coverage. Mr Anupam knew that at the time of announcement of next year's result, everybody was going to focus on this particular parameter. Hence, after returning from the Annual General Meeting, he immediately asked for the list of stressed accounts. While going through the list of accounts, he found that expected slippage in the first quarter was approx Rs. 2000 crore and majority of the expected slippage was in wholesale business segment. Although this figure was more than average quarterly slippage, he felt that it was still manageable.

First Quarter Results: A Grim Picture

It was the last day of first quarter, Recovery Department was flooded with several telephone calls from various parts of the country. Many new slippages were expected. Estimate for

Shri Vineet Kumar Jain (vineet.jain104@gmail.com) Chief Manager, Bank of Baroda, Baroda Apex Academy, Gandhinagar.

slippage was moving northward. Finally against the expected slippage of Rs. 2000 crore, actual slippage turned out to be Rs 4000 crore. Mr Anupam was furious. He immediately asked for the list of new NPAs. He was surprised to see that many "out of the blue" entries were there in the list. Mr Anupam remembered his promise to shareholders that the Net NPA level would not increase. He decided to assign this task to Mr Sunil Kumar. Mr Sunil Kumar was General Manager (Large Corporate Banking) and had experience of working in credit domain for more than 30 years. He made his point very clear to Mr Sunil, "Sunil, I have made a promise to our shareholders. I know that it is very challenging task but, I am sure that you will prove me right. I don't want any surprises in our quarterly results. Make sure that we detect any potential slippage well before time and take corrective action before it turns into NPA."

Strategy

Mr Sunil knew that macro economic factors were changing drastically and many stressed accounts were going to turn into NPAs. Hence first of all, he decided to identify those accounts which could turn into NPAs in the current financial year. While reviewing the existing method of identifying expected slippage, he found that list of expected slippage was prepared based on financial aspects only i.e. if the servicing of interest and/or principal payment was regular, then account was not reported as stressed accounts. He decided to change this methodology immediately. He asked his team to prepare the list based on financial as well as non-financial factors so that incipient sickness could be identified well in advance. He started with the illustrative list of some early warning signals (EWS) given by Reserve Bank of India (Annexure I) and started brainstorming with his team. Finally, they were able to find various early warning signals to identify incipient sickness. These early warning signals were classified in various category and circulated to all branches as below:

- Financial/Control Statement/Conduct of account. (Annexure II)
- At the time of Inspection of Unit/From Market Enquiries (Details as per Annexure III)
- Compliance of Regulatory/Statutory/Bank's guideline/Financial Statements (Annexure IV)

His decision to move from "financial aspects only" to "financial plus non financial aspects" bore fruits soon. Incipient sickness was identified in many small and mid size borrowers and corrective actions were initiated by bank officials.

Catch – 22 Situation

Mr Sunil knew that, although he had been able to track stressed accounts, the identification was too late, as half of the stressed accounts had already still turning into NPAs. Even Central Repository of Information on Large Credit (CRILIC) and Central Fraud Registry provided last minute identification of stress. He knew that with current pace of asset quality degradation, he was bound to fail. He immediately asked his team to contact all the inspection and audit office in the country and collect common modus operandi and reasons for accounts turning into NPAs. (Annexure V). Based on findings of this exercise, he decided to improve due diligence at various levels (Annexure VI). However, he was still not able to find the answer to the following questions;

- How to detect sickness well in advance so that slippage can be prevented?
- How to identify who was going to be the next willful defaulter?

It was a hectic day and already 9:00 PM. Exhausted after the day's work, he decided to leave for home.

A Game Changing Strategy – Think Like A Promoter

Even at home, Mr Sunil could not relax. His wife, Naina, asked him, "You look disturbed. Is everything OK?" Sunil told her that he was not able to find the solution to certain questions. Naina laughed and said," It is very simple. Haven't you seen Indian movies? If you want to catch a thief, you have to think like one. So if you want to know who is going to be next willful defaulter, then you have to think like a willful defaulter. Only then, you can catch the right signal at the right time." Mr Sunil felt as if he had found the PANACEA. He said to himself, "The captain is the first person who knows that this ship is going to sink. In this case, if the promoter wants to default or he knows that the future of the company is uncertain, then he will definitely protect his family members first. At the same time, he will try to safeguard interests of his children first. Accordingly, he will not infuse any fund further in his business and try to drain out the company by increasing his salary and perquisites. He will also try to divert the funds through subsidiary/associate concerns or fake debtors and creditors. At the same time, he will withdraw personal guarantee or will resign from the directorship." He decided to check the validity of this concept on sample basis on few existing NPA accounts. Next day, when Mr Sunil reached his office, he asked for the file which belonged to two NPA accounts *viz.,* SBL and GSML. He instructed his team to write down the unique information related to GSML and SBL on following parameters: Salary and Perquisites to promoters, Status of Fund Infusion/Personal Guarantee/Security, Non Core Assets, Related Party Transaction/Diversion of Fund and Buyer and supplier verification (Annexure VII). After going through the observations, he was sure that early warning signals existed well in advance but none of the bank officials was able to decode those signals. He asked his team to prepare a methodology to detect new warning signals and communicate the same to all branches. (Annexure VIII)

Social Media – An Insider View

Mr Sunil was happy that he was able to identify the probable stressed accounts. But, this list was too big and only an insider confirmation could clarify that there were certain issues with the company. He started brainstorming with his team. After discussion, they found that employees and customers were the independent insiders who could provide a true picture. It was decided to get a feedback of these two independent insiders. But, why would someone share his view with them? Vibhu, a young officer who joined his team recently, solved this problem. He informed Mr Sunil about various social web-sites and community platforms. He said, "Today people use social media to express their views on any topic. For example GLASSDOOR.com provides a platform to employees of the companies to share views on working style / issues with the company. Similarly, customers give their reviews on product and services of the company. For example, INDIA REALESTATEFORUM.com provides a platform to property buyers, where independent and true picture of any real estate company will emerge. These platforms will provide independent opinion on company's health." These methods worked very well for all types of customers. Administrative offices were sharing their success story with corporate office. One of the offices shared stating, "Satyam Exporter Ltd was enjoying significant credit facilities from our bank. The promoter of Satyam Export Ltd sent his son abroad from pursuing MBA in international business. There, his son incorporated a company and funds were diverted to this company by Satyam Export Ltd. Subsequently, the promoter approached the bank for a waiver of his personal guarantee. We got suspicious and after due diligence, we were able to understand the whole scenario.

Hard negotiation took place with the promoter and finally, he agreed to reduce his credit limits gradually." Another office shared that they were able to identify the stress when one of the employees posted on "GLASSDOOR.com" stating that he was not paid salary since the last two months. Finally, the hard work of Mr Sunil was showing results.

Conclusion

Mr Sunil was convinced with the former RBI Governer's statement stating, "Promoters do not have a divine right to stay in-charge regardless of how badly they mismanage an enterprise, nor do they have the right to use the banking system to recapitalize their failed ventures". Once the stress was identified, he utilized three R's – "Rectification", "Restructuring" and "Recovery" to full potential. It was the Closing of the current financial year and the Net NPAs of current year were reduced by 100 basis point compared to last year's Net NPAs. The team was jubilant. But, Mr Sunil was not the one to rest on his laurels. He congratulated his team and motivated them saying, "This is just the beginning. There are several unexplored areas which can be effectively utilized for our purpose. The basic idea is to BE VIGILANT, THINK LIKE PROMOTER and ACT ACCORDINGLY."

Annexure I

Some Early Warning signals which should alert the bank officials: Extract from RBI Framework for dealing with loan frauds:

1. Default in payment to the banks/sundry debtors and other statutory bodies, etc., bouncing of the high value cheques
2. Raid by Income tax/sales tax/central excise duty officials
3. Frequent change in the scope of the project to be undertaken by the borrower
4. Under insured or over insured inventory
5. Invoices devoid of TAN and other details
6. Dispute on title of the collateral securities
7. Costing of the project which is in wide variance with standard cost of installation of the project
8. Funds coming from other banks to liquidate the outstanding loan amount
9. Foreign bills remaining outstanding for a long time and tendency for bills to remain overdue
10. Onerous clause in issue of BG/LC/standby letters of credit
11. In merchanting trade, import leg not revealed to the bank
12. Request received from the borrower to postpone the inspection of the godown for flimsy reasons
13. Delay observed in payment of outstanding dues
14. Financing the unit far away from the branch
15. Claims not acknowledged as debt high
16. Frequent invocation of BGs and devolvement of LCs
17. Funding of the interest by sanctioning additional facilities
18. Same collateral charged to a number of lenders
19. Concealment of certain vital documents like master agreement, insurance coverage
20. Floating front/associate companies by investing borrowed money
21. Reduction in the stake of promoter/director
22. Resignation of the key personnel and frequent changes in the management
23. Substantial increase in unbilled revenue year after year.
24. Large number of transactions with inter-connected companies and large outstanding from such companies.
25. Significant movements in inventory, disproportionately higher than the growth in turnover.
26. Significant movements in receivables, disproportionately higher than the growth in turnover and/or increase in ageing of the receivables.
27. Disproportionate increase in other current assets.

28. Significant increase in working capital borrowing as percentage of turnover.
29. Critical issues highlighted in the stock audit report.
30. Increase in Fixed Assets, without corresponding increase in turnover (when project is implemented).
31. Increase in borrowings, despite huge cash and cash equivalents in the borrower's balance sheet.
32. Liabilities appearing in ROC search report, not reported by the borrower in its annual report.
33. Substantial related party transactions.
34. Material discrepancies in the annual report.
35. Significant inconsistencies within the annual report (between various sections).
36. Poor disclosure of materially adverse information and no qualification by the statutory auditors.
37. Frequent change in accounting period and/or accounting policies.
38. Frequent request for general purpose loans.
39. Movement of an account from one bank to another.
40. Frequent ad hoc sanctions.
41. Not routing of sales proceeds through bank
42. LCs issued for local trade/related party transactions
43. High value RTGS payment to unrelated parties.
44. Heavy cash withdrawal in loan accounts.
45. Non submission of original bills.

Annexure II

Financial/Control Statement/Conduct of account:

1. A/c is overdrawn for more than 30 days.
2. Interest overdue more than 15 days.
3. Variation in estimates/projection of sales>25% during the last quarter.
4. Delay in submission/non submission of Quarterly Sales figure > 30days.
5. Delay/Non submission of monthly stock/book debts statements > 1 month.
6. Return of cheques on financial grounds > 2 occasions in a month.
7. Invocation of guarantees/devolvement of L/Cs > 1 occasions in a month.
8. No credit in the operative account for consecutive 30 days.
9. Delay in servicing of term loan instalment > 30 days.
10. Return of bill purchased > 2 Bills in a month.
11. Past Due Bills>30 days
12. Over Due Export Packing Credit beyond 30 days.
13. Special Mention Account (SMA-0, SMA-1, SMA-2)
14. Significant reduction in Drawing power after stock Audit
15. Multiple request for Ad-hoc facility or Temporary Overdraft 12.

Annexure III

At the time of Inspection of Unit/from Market Enquiries:

1. Undue and unreported delay in project implementation.
2. Installations of sub standard machinery or machinery not as per the project report/approved quotations.
3. Frequent breakdown in plant/machinery.
4. Production noticeably below projected level of capacity utilization.
5. Labor problem and frequent interruptions in manufacturing.
6. Non-availability of vital spare parts.
7. Production of unplanned items without reporting to the Bank.
8. Disposal/replacement of vital plant and machinery without Bank's knowledge.
9. Downward trend in sales.
10. Higher rate of rejection at process stage/final stage/after sales.
11. Delay in or failure to pay statutory dues.
12. Diversion of working capital to capital expenditure or for other use.
13. Abnormal increase in debtors and creditors.
14. Increase in inventory which may include large quantity of slow and nonmoving items.
15. General decline in the particular industry combined with many failures.
16. Rapid turnover of key personnel.
17. Filing of law suits against the company by its customers, creditors, employees etc.
18. Unjustified rapid expansion within a short time without appropriate financial tie up.
19. Sudden/frequent changes in Management/infighting within the management.
20. Reduction in profit/unit starting incurring losses.
21. Dependence on single of few buyers/no alternate market for product.
22. Threat of action against the borrower from statutory bodies e.g. pollution control, Labor Welfare dept, Income tax/sales tax/Octroi/excise/Customs Dept etc.
23. Poor or dubious record maintenance.
24. Loss of key product lines, franchises, distribution right or sources of supply.
25. Speculative inventory acquisition not in line with normal purchasing practices.
26. Poor maintenance of plant/machinery.
27. Lack of planning /poor planning.
28. Apathy of promoters/owners in running the business.
29. Adverse market reports on the borrower/concern.
30. Loss of crucial customers.

Annexure IV

Compliance of Regulatory/Statutory/Bank's guideline/Financial Statement:

1. Effluent treatment plant/Sewage treatment Plant not working properly
2. Pollution clearances not obtained
3. Security perfection pending for more than 6 months
4. Change in management without bank's permission
5. Consortium meeting not held regularly
6. Control statements not submitted
7. Declining trend of N.W.C.
8. Diversion of short-term sources in long-term uses
9. Steady decline in sales
10. Steady decline in profitability
11. Worsening current ratio & D.E.R.
12. Continued occurrence of cash losses
13. Decline in tangible net worth
14. Decline in turnover of assets
15. Accumulation of statutory liabilities

Annexure V

Common reasons from inquiry report of inspecting officers Common Modus Operandi:

The group floated multiple companies in the name of their associates. Thereafter, these companies availed various fund based and non-fund based credit facilities from a number of banks under consortium/multiple banking arrangements including our Bank. The Companies availed Term Loans from consortium banks by submitting invoices of non-existent suppliers, fictitious companies floated by the group promoters/directors themselves. Disbursement of Term Loans was made through RTGS to the Lead Bank for the credit to the Escrow Accounts of the Companies. The funds were further transferred from the 'No Lien' account to the accounts of suppliers, borrower companies and group accounts, by way of DDs, RTGS at the request of the borrowers. The Companies diverted funds by furnishing fabricated quotations/fake invoices from various supplier companies, who either did not exist or had not issued such invoices. In some cases, the accounts of these suppliers were opened by promoters/directors of the group itself indicating the fact that the borrower and supplier companies were floated by the promoters/directors of same group. The funds, after being credited to the accounts of the said suppliers, had been further credited/transferred to other companies where the promoters/directors of group concerns, were directors/authorized signatories. The funds had been siphoned off and there had been circular transactions amongst the group companies. Bank sanctioned credit facilities to the borrower company under consortium arrangement with another bank. When the account turned NPA, the lender banks arranged for forensic audit of the borrower account. Forensic audit revealed that the borrower company had floated multiple companies, with employees as shareholders/directors etc., for diversion of funds without any actual trade/sales taking place. The funds were diverted for other purposes.· The borrower was sanctioned domestic factoring facilities. It was observed that the addresses given in the debtor statements were fictitious and, they were very small companies with questionable source of wealth. Multiple invoices were issued each day. Lottery receipts were not provided and, the same were declared as transported by own vehicles. Further, repayments had not been done by the debtors. But, were made by the borrowing company. Bank sanctioned various credit facilities to the borrower. On investigation after the account turning NPA, it was revealed that the Branch Head had sanctioned several loans/credit facilities against mortgage of properties which were over-valued and thereby, facilitated the borrowers to avail of higher loan amount. Further, the loans were sanctioned on the basis of fabricated financial statements/balance sheets. The loans were also sanctioned to non-existing firms and thereby facilitated the borrowers to misutilise bank's funds. Common Reasons. Branches had not scrutinized documents properly. Many accounts turned into NPAs as all the submitted documents were fabricated. It was observed of fudged financial statements, inflated security valuation reports, defective search reports for title deeds of mortgaged property were also seen in various cases. It was also seen that many borrowers were Willful defaulters. They had capacity to repay but they were not willing to repay the full amount. Go-downs where the hypothecated stock was reportedly stored, did not exist and, no stock was available indicating misappropriation/diversion of funds.

Annexure VI

Improve Due Diligence:

Carry out independent formal due diligence (i.e., verification of DIN Nos, PAN No. CIBIL, RBI defaulters list, ECGC caution list etc) and informal due diligence (i.e., collecting market information about the borrowers, credentials of the promoters, position of the industry in the economy, Group company performance etc) before sanction/disbursement, instead of completely relying on the information/appraisal of consortium leader. · Check independently, the veracity of the invoices/quotation/credentials of the suppliers and its promoters through various sources, viz. MCA portal, internet , market intelligence , even if , it is already done by the Leader of the Consortium. Convene quarterly consortium meeting on regular basis including timely sharing/exchange of complete information in respect of conduct of the account, IRAC status and other issues as per extant guidelines. Carry out post-disbursement inspection/Stock Audit/Unit Inspection by concurrent auditor as per stipulated norms and deficiencies, if any, detected be critically examined and sorted out immediately. Keep close watch on the account like routing of turnover, diversion of fund through regular inspection of stock/book debt/other assets. Prompt action to be initiated on early warning signals, viz. poor turnover, principal/interest on loan not settled on due date, invocation of BG/ LC liability, adverse market reports, etc.

Annexure VII

Information related to GSML and SB:

(A)GSML GSML was dealing with ABC Bank Ltd since its inception. It was a vertically integrated company operating in the man-made textile space that manufactures Polyester Chips, Polyester Filament Yarn (PFY), Preparatory Yarn, Woven (Grey) Cloth, as well as Dyed & Printed Sarees and Dress Materials.

Area Observation: Salary and Perquisites Board of Directors had been paid an amount of Rs. 46.69 crore in the form of Salary & Perquisites, Sitting fee and commissions during last five years. As per last audited financials, it was decided to nearly double the Salary & Perquisites for promoters. Fund Infusion/Personal Guarantee/Security Net worth of the company had eroded as per last audited financials and promoters were not infusing any fund. Promoter's contributions of Rs. 30 crores were committed by CMD of GSML in the last financial year. However no amount had been infused. In past, they had declined to offer personal guarantee and their stance remained the same. Promoter's net worth was very low as compared to heavy exposure taken by the company. In consortium meetings, member banks asked for details of uncharged assets belonging to GSML/Associate Concerns as well as in the name of Directors. Representative of the company replied that all other properties were mortgaged to banks. Wife of one of the promoters was also a director in GSML. She resigned three years back.

Non Core Assets: As per Inspection report of unit, the company has 5 plants. Four plants were working at almost 95 per cent capacity while one plant was shut down. The reason given by the company for shutting down plant was insufficient demand as well as short supply of Raw Material. Investment made in this plant was significant. Further, projected utilization level of this plant was at 0 per cent till FY 2020. The company purchased freehold land of approx Rs. 5.70 crores in the last two financial years.

Related Party Transaction/Diversion of Fund: GSML paid commission expenses of Rs. 4.82 crores to his subsidiary. Credit turnover in the Sister concern, STML, was approximately twice of sales of STML. GSML had done transactions with several sister/associate concerns. There are multiple companies in the list of MCA which are showing registered email ID, same as company's email ID. GSML has large number of sister/associate concerns which were having significant transactions during the year with GSML. It was observed that GSML had invested a good amount in subsidiary through direct investment or unsecured loan. Similar pattern was observed in other group concerns. The company had opened current account with non lenders Buyer and Supplier Verification No major adverse observation .

(B) SBL SBL was engaged in manufacturing of Plywood, Block Board and Recon Plywood. The products were well accepted in the market and being sold through the network of distributors spread all over India. Area Observation:

Salary and Perquisites Ratio of salary to sales was on the higher side. Fund Infusion/ Personal Guarantee/Security Net worth of the company had eroded as per the last audited financials Promoter was submitting fake certificate for fund infusion. In past they had declined to offer personal guarantee of other family members and their stance remained the same. Promoter submitted that no additional collateral security was available in his name. Wife of the promoter was also the director in SBL till few years back. Thereafter,, she resigned. Non Core Assets of the company were having obsolete stock and machinery.

Related Party Transaction/Diversion of Fund: There were certain significant transactions wherein substantial amounts had been paid/transferred to parties which were not appearing in the monthly lists of Sundry Creditors of the borrower, as submitted along with the stock statement There were certain transactions wherein the credits received on a particular day from selected parties (which are not appearing in the list of debtors as submitted by the borrower) had been transferred to some other parties (majority of which are not appearing in the list of creditors as submitted by the borrower) on the very same day. There were several transactions with the sister/associate concerns who were enjoying credit facilities with various banks. SBL had done transactions with several sister/associate concern.

Debtors of the SBL were having same email ID on MCA portal. SBL has large number of sister/associate concerns. These concerns were having significant transactions during the year with SBL. It was observed that SBL had invested good amount in subsidiary through direct investment or unsecured loan. Similar pattern was observed in other group concerns. The company had opened the current account with non- lenders

Annexure VIII

Methodology of Detecting New Warning Signals:

1. Salary and Perquisites to promoters:
   - *(a)* Check Salary to Net Sales ratio (it should not be more than industry average)
   - *(b)* Promoter should not increase his salary or Perquisites, when the company is making losses
2. Status of Fund Infusion/Personal Guarantee/Security:
   - *(a)* If the promoter asks for waiver of personal guarantee on flimsy ground
   - *(b)* Request for withdrawal of personal guarantee of promoter or his family member was received
   - *(c)* No infusion of fund/No security was offered by the promoter at the time of stress
3. Non Core Assets:
   - *(a)* If company was investing in unrelated activities/assets
   - *(b)* Significant investment was lying idle and, management has no plan for its monetization.
4. Related Party Transaction/Diversion of Fund:
   - *(a)* Multiple companies float by directors/Promoters in recent past
   - *(b)* Any subsidiary/associate involved in same line of activity with same buyer and supplier
   - *(c)* Certain transactions wherein the credits received on a particular day from selected parties had been transferred to some other parties (both parties are not in debtor/creditor list).
   - *(d)* Transactions with non business related entity (Round entry without any business justification)
5. Buyer and supplier verification:
   - *(a)* All buyer should not be located in any particular area.
   - *(b)* Buyers should not have common director/email/Auditor etc.
   - *(c)* Activity should be the same

Teaching Notes

Learning Objectives:

1. Changing banking scenario and difficulties in credit monitoring
2. Importance of Early Warning Signals
3. Different type of Early Warning Signals
4. Tools/ Sources for Early Warning Signals
5. Use of Social media

Suggested Reading:

A. Changing banking scenario and difficulties in Credit Monitoring
   1. Asset Quality of Indian Banks: Way Forward, Key note address delivered by Shri N. S. Vishwanathan, Deputy Governor, Reserve Bank of India at National Conference of ASSOCHAM on "Risk Management: Key to Asset Quality" in New Delhi on August 30, 2016.
   2. Asset Quality Challenges in India: Diagnosis and Prognosis; Keynote address delivered by Shri S. S. Mundra, Deputy Governor, Reserve Bank of India, at the Edelweiss Credit Conclave held in Mumbai on April 28, 2016

B. Importance of Early Warning Signals
   1. LOAN FRAUDS- NEW FRAMEWORK, circular DBS.CO.CFMC.BC.No.007/ 23.04.001/ 2014-15 dated May 7, 2015 2. Master Circular on Willful Defaulters - RBI (2015)

C. Annual Review and Forensic Audit of Corporate Borrowal Accounts and Early Warning Signals
   1. Deepak Narang & V S Kaveri, Vinmay, NIBM C. Different type of Early Warning Signals
   2. Frauds in the Indian Banking Industry, Working paper No 505, Charan Singh, RBI Chair Professor., Economics & Social Science, Indian Institute of Management Bangalore
   3. Credit Monitoring, Legal Aspects and Recovery of Bank Loans by D D Mukherjee.

D. Tools/ Sources for Early Warning Signals:
   1. http://www.mca.gov.in/Ministry/pdf/MCAV2Release 2_Help.pdf - MCA Website, Help on using MCA portal

E. Use of Social media:
   1. https://www.facebook.com/help/460711197281324/
   2. https://www.linkedin.com/help/linkedin/answer/302/searching-onlinkedin?lang=en X.

Teaching Plan:

A. Changing banking scenario and difficulties in credit monitoring class should be started with questions on following issues· Why monitoring large accounts is difficult? Changing behaviour of corporates – why more and more corporate are defaulting willfully? Various factors affecting performance of corporates.

B. Existing method of due diligence and what they don't capture (Existing methods can verify papers but cannot tell about intention of the borrower) Now they may be asked to write down issues in credit monitoring and also in detecting early warning signals. Here, introduction of concept can also be provided.

C. Importance of Early Warning Signals: The above mentioned Master circular of RBI can be provided as handout on the very first day of the program and they may be asked to share their views on early warning signals. Participants should appreciate the fact that the RBI has taken initiatives like CRILIC and RFA for better information sharing among banks.

D. Different types of Early Warning Signals: Participants must be explained that different early warning signals can be detected at different point of time. While some signals are clearly visible at the time of inspection while others will be noticed when we will compare financials with the peer group. They may be asked to prepare their own list of early warning signals and detect them while working in credit department. Various categories like internal/external or operation, financial, conduct of account, management etc may be explained.

E. Tools/Sources for Early Warning Signals: Search on MCA portal should be explained. Effective use of MCA portal can provide various EWS. For example, the following information can be seen on MCA portal: location, activity and common directors of debtors can be verified' Authenticity of financials can be verified. Using the DIN number, associate and subsidiaries can be searched etc. Probe. zaubacorp.com etc can also be used.

F. Use of Social Media: The importance of social media in detecting early warning signal should be explained. Live demonstration of indiarealestateforum.com or glassdoor.com may be shown to participants.

Due Diligence in Qualitative and Quantitative Aspects

Shri Sumit Garg

Mr Rahul Srivastav is working as a Branch Manager of Clock Tower Ludhiana Branch in Bank of Baroda. Total Business of the Branch is Rs. 500 crore out of which Rs. 240 crores are advances. SME advances of the branch contribute to Rs. 125 crores and Retail advances Rs. 95 Crores. Branch has received a proposal from ABC Partnership firm for take over its credit facilities with enhancement in limit.

Being a credit officer in the Branch, give your comments on viability in the proposal considering qualitative and quantitative aspects. Detail of the proposal as under.

Keywords: Branch Due Diligence, Credit Appraisal, Credit Decision Making

Case on ABC Partnership Firm

Background of Firm

M/s ABC Partnership firm is engaged in the trading business of Mobile Handsets. The Partnership firm was incorporated on 5th April 2015 by Partners Mr Anand kumar and Mr Garish Patel. They are carrying out the business for last 3 years. Mr Anand Kumar is the Key promoters of the firm. The firm is mainly trading in mobile phones in the range of Rs 3000 to Rs. 7000 per handset and the same are imported from China. M/s ABC firm purchases the mobile handsets from various vendors mainly from the SK Telecom, China Telecom, XO Mobiles, ZIOMI China etc and sell them to the customers in Punjab, Delhi, Rajasthan, and Gujarat.

Firm purchases the mobile handset from 10 to 12 vendors out of which only 5 vendors contribute approximately 75 per cent of total purchase .The firm is selling mobile handset to about 50 Retail shopkeepers out of which major sales come from 10 Retail shopkeepers which is around 70 per cent of total sale. Firm has been able to register a drastic growth in sales turnover in a very short period.

Background of the Promoters

Mr Anand Kumar started his business from his college life itself and he has passed out from Punjab University Chandigarh. He is 48 years old and having 28 years experience of trading business and has run many successful trading businesses. He told that Mr Anand Kumar has left all his previous business in time and made lots of money. This is his sixth business and He is staying in a rented house with his wife and daughter for last 3 years in Ludhiana.

Shri Sumit Garg (sgarg1406@gmail.com) Senior Manager & Faculty, Bank of Baroda Academy, Chandigarh.

Mr Garish Patel is 47 yeasr old and has been associated with Mr Anand Kumar for last 3 years. He is having lots of ancestral properties.

Existing Banking Details

The firm is presently enjoying Cash Credit facility of Rs 455.00 lacs and LC of Rs 200 lacs from OBC Bank. Now they have decided to shift account to Bank of Baroda. Conduct of account as per statement of account appears satisfactory. Details of existing banking arrangement mentioned is a under:

Banking Arrangement (Working Capital)

(Rs in lacs)

Name of Bank	*Fund Based*				*Non-fund Based*			
	% Share		*Amount*		*% Share*		*Amount*	
	Exist.	*Prop.*	*Exist.*	*Prop.*	*Exist.*	*Prop.*	*Exist.*	*Prop.*
OBC	100	0	455	0	100	0	200	0
Bank of Baroda	0	100	0	700	0	100	0	200
Total				700				200

The above loan is secured by equitable mortgage of 5 immovable properties and all the properties belongs to Mr Garish Patel and as per valuation report of OBC bank value of the property is Rs 900 lacs.

Value of Securities

Sr. No.	*Description*	*Value on lacs*
A	Primary	
i	Hypothecation of goods (Mobile handset)	1150
ii	Debtors less than 6 months	200
iii	Debtors more than 6 moths	50
	Total	1400
B	Collateral	
	Equitable mortgage of immovable properties	900
A+B	Grand Total	2300

Mr Anand Kumar alone takes care of entire business of Purchase of Mobile handset from all vendors and sells the handsets to different customer segments.

Financial Papers Submitted by Borrower

Mr Anand Kumar is a key promoter and he alone takes care of entire business. He submitted two year Audited BS and PL of FY 2015-16 and 2016-17 and last year BS/PL i.e 2017-18 is yet to be audited. Current Year Estimate of BS and PL and next two years projection along with GST returns of FY 2017-18 and account statement of last Financial Years also submitted.

The ABC firm has achieved sales of Rs 25 crore in FY 2015-16, sales of Rs 52 crore in FY 2016-17 and sales Rs 80 crore in FY 2017-18. Firm is able to generate profit of Rs 2 crore, Rs 3.5 crore and Rs 5 crore respectively in each year. As per Balance Sheet of FY 2016-17 closing Debtors is Rs 5.20 crore and in FY 2017-18 closing debtors is Rs 9.30 crore. Details of bank account statement mentioned is below:

Quarter Ending	*Debit (Rs crore)*	*Credit (Rs crore)*	*Number of times O/S above the sanction limit*
June 2017	19	16	3
September 2017	23	20	3
December 2017	21	21	1
March 2018	15	17	0

The firm has submitted the GST return for the FY 2017-18 and the returns shows the total sale of Rs 80 crore which is tallied from the PL statement submitted by the borrower.

Assignment of the Participant

Assume you are the processing officer of the Bank of Baroda and In light of the above details you have to decide whether the above loan can be sanctioned or not. Discuss in complete details of Due Diligence Process at the time of sanction.

1. Which aspect is more important when appraising a proposal?
2. Which additional information you will collect from other sources?

Facilitator Note

Learning Objective

1. Participant to know the Method of Borrower Appraisal as part of credit decision.
2. Understand the Importance of Due-Diligence in making a credit decision.
3. Understand what all vital data we should collect about borrower's conduct while analyzing an account statement.
4. Understand the importance of Market Report, sources for the same etc.

Qualitative Appraisal of above Case Study

Character and Capacity

As per the above case, there is some doubt in character and capacity of the business and the Promoter because current business is running for just 3 years and the key promoter changing his business every time after 4 to 5 years. This is his sixth business. There is a chance that the key promoter of business is not paying dues of his previous supplier or employee and exits from the business without intimating anyone. Under the circumstances, detail enquiry about his previous firms, its whereabouts and affairs in the business is required to be taken into consideration.

Capital and Collateral

Age of key Promoter is 48 years and he is staying in a rented house with his wife and daughter. He must have his own house because he is engaged in business for the last 28 years and he has earned a good amount of profit from all his previous businesses.

Collateral is not from the key promoter which shows suspicious in the mind. Only the second Partner offering collateral of Rs 9 crores though he is not a key person of the business.

Check Point for Banker in above case study as per Qualitative Appraisal

1. Credit Officer should ask from the Promoter that he is having 28 years experience of business and earns a good amount of profit from all his previous business. Why he is staying in a rented house? Where he invests all his profit from all previous business? Collect Documentary proof of his investment.
2. Why the key promoter is not offering any collateral security, in spite of earning a good amount of profit from all his previous business. Banker should insist some collateral security from the key Promoter also
3. Banker should ask the detail of main suppliers and customers of the key promoter's previous business. Enquire from them and also from reputed people in the same industry about key Promoter. If banker receives positive report, it is good.

Check Point for Banker in above case study as per Quantative Appraisal

1. Credit summation in the bank account statement is the cash realization from sales which means Opening Debtor + Sales – Closing Debtors. In the above case, total sale of firm as per GST is Rs 80 crore, total credit summation in account is Rs 74 crore Opening debtor is Rs 5.20 crore , closing debtor is Rs 9.30 crore. This means, total credit in account of sale is Rs 74-5.20+9.30=78.10 against the sale of Rs 80 crore. So, Rs 1.90 crore sale is not routed through the account.
2. The banker needs to check the cash book of the borrower for Rs 1.90 crore sales. There is a chance of fake sale and the borrower is maintaining an account with other bank.
3. Banker to check credit summation for current year *vis-à-vis* previous year quarter wise.
4. Banker to check whether there is timely payment of statutory dues through the account like TDS, GST, PF deposited by company, Salary Payment of Employees etc.
5. Analysis of average utilization of CC limit, cheque returns, penal interest and excess/ overdue. In the case, there is a regular excess in the account which is a negative sign.
6. Annual sale is above Rs. 2 crore
7. Check the debtors' and creditors' names matches with account statements and stock statement.
8. Age wise break up of debtors and creditors should be obtained.
9. Banker should check genuine reasons for the fund requirement and the amount requested.
10. Banker should go through MCA website and Probe 42 in a company case, CIBIL data, and RBI willful defaulter list.

11. Cross check the closing stock of balance sheet with the stock statement submitted by the borrower.

12. Take documentary proof for calculating net worth of the borrower and the branch should analyze the net worth of Mr. Anand Kumar and also ascertain the movement in capital of Mr. Anand Kumar in business to ascertain his genuineness.

13. Check the nature of the collateral, valuation and security quality issues.

14. Check the nature of the goods mentioned in the GST returns vis-à-vis nature of Goods the firm is selling.

15. Major amount of working capital is blocked in stock as evident from the security column. Branch may verify the godsown of the firm and ascertain the availability of the actual stock in comparison with stock statement submitted by the borrower.

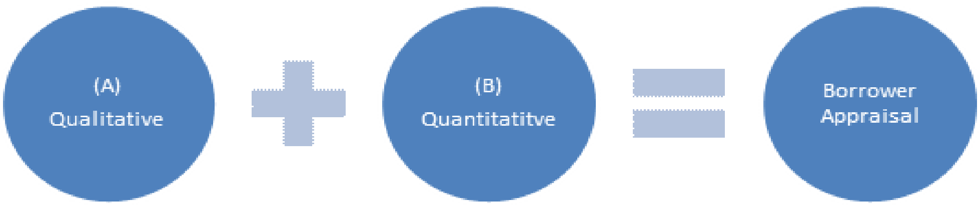
16. Branch to analyze financial ratios of the firm based on audited as well as provisional Balance Sheet to ascertain the financial condition in the firm.

17. The credit opinion report may be called from the existing banker in RBI format, seeking the conduct in the account along with other information including securities details with them

18. After receipt of the above information/papers and analysis the banker shall be in a position to decide on the proposal.

Suggestive Study Material for Facilitator

Borrower Appraisal should be with Qualitative and Quantitative Method



Qualitative Appraisal Basis on the Intention of Borrower and Judgment of Credit officer. For this we have to follow 5C's principal

Character refers to a borrower reputation/integrity/intention or track record for repaying debts. This is the most important selection criteria for credit appraisal.

Capacity lender look at the length of time an applicant has been at his business/job and stability of business/job along with the examining of income.

Capital lender considered any capital the borrower puts towards a potential investment. Large Contribution by Key promoters and dependent on the business for his livelihood and the business has good opportunity to grow all these things reduce the chance of default.

Collateral If a key promoter is giving good collateral as security – especially residential house in which he is staying with his family, it indicates that the borrower is confident about his business and it reduce the chance of default.

Conditions refer how a borrower intends to use the money. Lender will also considered economic environment, Government guidelines for industry that could affect the business. So put condition in sanction accordingly like Pollution control License required etc.

Quantity Appraisal includes verification of documents which include

1. Loan Application along with Check List
2. Bank Statements and GST Reurns
3. Audited Financial Statements
4. Stock Statement along with Debtor/Creditor List
5. Property papers along with Net Worth

Loan Application

All pages of loan application to be filled up carefully and signed by the applicant. At the time of documentation banker should ensure that same signature matches with the application form and obtained all documents as per check list.

Through application form banker able to know activity of the business, key person profile, Detail of Machinery, Financial of the company, Statutory obligation, facility requested, security offered etc. for our cross verification.

Bank Statements and GST Return

Credit officer has to obtained account statement for completed last Financial Year and current year till date for check the previous conduct from the banking records of the borrower.

Through bank account statements credit officer are able to know total credit in account in comparison of sale, Cheque Dishonor, Account overdrawn, Payment of Electricity bill/ salary etc regularly, Payment of GST etc.

Cross Check the nature of goods mentioned in GST and the nature of Goods Firm is selling. For ex. Firm is a manufacturing Unit and in GST return we see that the company is also trading other item.

Audited Financial Statement

Credit officer should obtained last 3 year audited financial statements along with notes to account for existing business and current year estimate along with the projection of coming year.

Previous year financial statement to be audited before 30 September of current year if audited statement of previous year not available credit officer can considered provisional statement subject to condition that variation in audited and provisional is not more than 5 per cent.

Stock Statement along with Debtor/Creditor List

The Stock statement along with Debtor/Creditor list of March submitted by borrower must be tallied with Audited Balance Sheet. If the details of Debtors/Creditors are found to be unrelated to the core business of the borrower, then there is a possibility of fake sale. Age wise break up of debtors to be prepared and checked outstanding more than 6 months for not considering under current asset.

Risk Management: A Case Study on Derivative

Shri Raj Kumar Sharma
Shri Rakesh Mamodia

Introduction

Derivative is a financial instrument:

(a) Whose value changes in response to the change in a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index, or similar variable (sometimes called the underlying)

(b) That requires no initial net investment or little initial net investment relative to other types of contracts that have a similar response to changes in market conditions; and

(c) That is settled at a future date

In an exposure linked to variable whose value keeps on changing, it becomes very difficult to protect against adverse movement of the variable a company/individual is exposed to. Derivatives are financial instruments structured to partially or fully transfer the risk to the counterparty that is willing to take the risk at a price.

The origin of derivatives can be tracked back to 1865, when the Chicago Board of Trade has introduced first commodity futures. India has adopted market determined exchange rates in March 1993 thus setting a direction of structural reform. In 1994, the Rupee was made fully convertible on current account. Banks were allowed to book forwards and cross currency options not involving rupee, foreign currency-rupee options and swaps for effective hedging of their customer's foreign currency exposures. Authorized dealers (banks) in India were allowed to offer Interest Rate Swaps (IRS) and Forward Rate Agreement (FRA) in 1999. The basic purpose of introducing these derivative products was to allow corporates to hedge their interest rate/exchange rate risk for their trade and balance sheet purpose.

The basic principal behind introducing Over The Counter (OTC) derivative is to provide tools to mitigate risk arising out of foreign currency and interest rate exposure.

Need of Study

Derivative being complex in nature and new to India, a significant gap was there in the understanding level of the corporates, bankers, and other related parties including regulators. Due to this gap, the derivative positions taken by corporates in year 2006-07, 2007-08 and have matured during/after the collapse of Lehman Brother (Investment Bank in USA), were an after effect of Sub-Prime Crises has resulted in significant losses to the corporates.

A need was felt to understand conditions prevalent during that period resulting in such huge losses.

Shri Raj Kumar Sharma and Shri Rakesh Mamodia (raj462001@gmail.com, rmamodia@gmail.com) Assistant General Managers, State Bank Institute of HRD, Indore.

Scope of the Study

The study is confined to understanding the deals prevalent during the period under consideration and the impact on related parties on account of adverse movement in the underlying.

Methodology

A case similar to those prevalent during the years before Sub-Prime Crises has been drawn to understand the impact of lack of understanding and non-adhering to risk management practices.

Keywords: Risk Management, Derivatives, Corporate Governance

Section I
The Case

M/s Doordarshi Pvt. Ltd. was a company incorporated in year 1972 as a closely held company promoted by Shri Tej along with his close relatives. The company was into manufacturing of garments. In the initial days, the company used to procure raw material from the domestic markets and also selling the finished goods domestically. The margins in the business were attractive and company had shown significant improvement in the performance over the years. The decade of 1980s' and 1990s' saw the company performing very well with no major issues being faced other than some isolated events of employee unrest in the company on account of demand for hike in the wages. The management handled all these issues tactfully and thus, not to impact the operations significantly.

After liberalization in Indian economy, there was a boom in cross-border trading. The company also ventured into International trade activity. It also shifted the purchase of cotton yarn from domestic markets and started importing it from China and Pakistan on account of price differential. It also started exporting manufactured garments to western countries, particularly to United States and European Union.

Due to this change in business plan of the company, it required higher funding for its operating activity. Therefore, the company approached a Bank named Smart Bank Pvt. Ltd., for working capital facility along with Export Packing Credit, Bill Discounting and Letter of Credit facility.

The Bank found it to be an attractive proposition and went ahead with sanctioning the required facilities and secured the loan with adequate tangible collateral securities along with the primary security, which was the asset being created out of bank finance. Further the promoters strengthened the proposal by providing their personal guarantee.

The company was doing good and repaying the bank's dues on time. They were routing sales through the Cash Credit account maintained with the Bank.

During the month of June 2006, the company received an order for export of USD 2.50 million worth of readymade garment to a company situated in USA. The company successfully executed that order and booked a handsome profit on the deal. Due to this deal, the company was also able to establish new connection in the given geography.

Now the company started receiving export orders regularly from the same party and the export business as well as import business book of company was increasing.

During the meeting with board of directors, the CEO of the company highlighted the foreign currency risk associated with such exposures (Exports and Imports). As the dependence on export revenue was increasing, the need for hedging of the foreign currency exposure was felt. It was also discussed that the company might be forced to book lower revenue in Rupee term, if there could be an adverse shift in exchange rate.

The board, then advised the CEO to approach a consultant in this regard and submit the report in the next meeting. The CEO availed the services of a private forex consultant and submitted the consultant's advisory in the next meeting. The advisory was very clear about the need for hedging for its foreign currency exposure with suitable tools, effectively.

In between as the export orders were increasing, the company found that the existing production facilities were inadequate and approached the Smart Bank to sanction the Term Loan for capacity expansion.

Looking to the past performance and the future prospects of the company the Smart Bank was also very comfortable with the company and sanctioned a Term Loan of Rs 5 crore to be repayable in 6 years after completion of a moratorium period of 1 year. The company also agreed to serve the interest during the moratorium period.

After the full disbursement of Rupee Term Loan, company CEO approached the bank and requested to explore the possibilities for reduction in interest rate on the term loan, as he was of the view that interest @12.5 per cent p.a. was way too high. But, the Smart Bank showed its inability to reduce the interest, as the cost of borrowing for the Smart Bank was not permitting it to provide any loan below a benchmark lending rate of 10 per cent and 2.5 per cent was the spread as determined by the company's risk rating.

The First Deal

With a need to reduce the interest burden, the C.E.O of the company approached the consultant once again who suggested him to explore the derivative product – Rupee – Dollar Swap.

Derivative is a financial instrument, whose value changes in response to the change in a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index or similar variable (sometimes called the underlying) and that requires no initial net investment or little initial net investment relative to other types of contracts that have a similar response to change in market condition and that is settled at a future date.

Swap is a derivative contract where two parties enter into an agreement to exchange cash flows as per agreed arrangements. So in Rupee – Dollar Swap one party moves from Rupee liability to Dollar Liability and other party will move from Dollar Liability to Rupee liability at some agreed cost.

By undertaking the Rupee – Dollar Swap the M/s Doordarshi Pvt. Ltd., was looking to convert its Rupee liability to US Dollar Liability to earn something in form of interest carry.

The structure they have entered was as under

Date of Trade	:	02nd February 2007
Maturity Date	:	15th July 2008
Spot Reference	:	44.10
INR Notional	:	Rs. 2,75,62,500
USD Notional	:	USD 0.625mio

Deal Structure

1. Initial exchange of principal: Nil
2. On maturity M/s Doordarshi Pvt. Ltd. to pay USD 0.625 million and Receive INR 2,75,62,500
3. M/s Doordarshi Pvt. Ltd. to receive interest @ 3.5 per cent per annum on the USD notional at quarterly intervals.

Risk in the Structure

In the above structure the risk factor was depreciation of Rupee against USD beyond the coupon received by M/s Doordarship Pvt. Ltd. i.e. 3.5 per cent

The scenario analysis of this structure is as under

Scenario 1: If on maturity the USDINR rate is more than 44.10, say it is at 46.10 than M/s Doordarshi Pvt. Ltd. will have to buy USD 0.625 million from market @ 46.10 i.e. by paying INR 2,88,12,500

Scenario 2: If on maturity the USDINR rate is equal to 44.10 than M/s Doordarship Pvt. Ltd. will buy USD 0.625 million from market @44.10 i.e. by paying INR 2,75,62,500

Scenario 3: If on maturity the USDINR rate is less than 44.10, say it is at 42.10 than M/s Doordarship Pvt. Ltd. will buy USD 0.625mio from market @ 42.10 by paying INR2,63,12,500

The initial thought was that M/s Doordarship Pvt. Ltd. would be meeting the USD liability under the structure from the export receivable and would not be looking for buying the USD from market.

The company entered into the above deal in February 2007 and subsequently the Rupee started appreciating and in the month of March on 29th March 2007, it has touched the level of Rs. 42.790. Further the appreciation trend of Rupee continued and it touched the level of 40.575 on 26th April 2007. At that time, the company felt that it could get a handsome profit on this deal, if it unwind the same i.e. the POS – Principal only Swap.

The Greed

Initially the board members were reluctant to unwind the deal as their purpose of entering the same was to use it for the entire period for interest rate benefit and not to earn profit or speculate. But later on, they decided to unwind the deal on 04th June 2007 @ 40.20 and booked a sizable gain on account of this unwinding.

This episode created a very good name for the CEO as well as the private consultant in the company.

Further on the basis of advice given by the private consultant and as per the understanding reached between C.E.O. and promoters of company, the company decided to enter into many such derivative deals to earn money as they find it to be an easy way of earning money. Further they also had export receivables to be used as underlying.

After some time in the month of August, the company entered into another derivative contract, which was different than the earlier one. The details of which are as under-

The Second Deal

Trade date	01st August 2007
Start date	03rd August 2007
Maturity date	15th July 2008
Settlement date	17th July 2008
Amount	USD 0.625 million and CHF @ 1.2009 is 0.7505
Sport ref (USD/CHF)	1.2009
Structure	USD CHF POS with embedded option on maturity
Transaction details	
Initially exchange of principal	NIL
Principal Exchange at the end	M/s Doordarshi pvt ltd to buy USD 0.625 million and sell CHF @1.2009
M/s Doordarshi pvt ltd to receive	1.40 per cent p.a. on USD notional
M/s Doordarshi pvt ltd to pay	NIL
Exchange of coupons	at the end
Embedded option	(Option Type – American Barrier, European Exercise)

M/s Doordarshi Pvt. Ltd. buy USD PUT CHF CALL @ 1.2009 with K/O @ 1.10 for USD 0.625 million

M/s Doordarshi Pvt. Ltd. Sell USD CALL CHF PUT@1.2009 with K/I at 1.28 for USD 0.625 million

Scenario Analysis

M/s Doordarshi Pvt. Ltd. receives 1.40 per cent p.a. coupon on the USD notional. Actual/ 360.

On the principal leg M/s Doordarship Pvt. Ltd. has a liability to pay CHF 750562.5 (USD 625000 X 1.2009) on maturity

Scenario 1: 1.28 and 1.10 both levels are never seen then M/s Doordarshi Pvt. ltd. buys the CHF form the bank @ 1.2009 if USD/ CHF is below 1.2009 or at SPOT if USD/CHF is above 1.2009.

Scenario 2: 1.28 and 1.10 both levels are seen then M/s Doordarshi Pvt. Ltd. buys the CHF @ spot if USD/CHF is below 1.2009 or @ 1.2009 if USD/CHF is above 1.2009.

Scenario 3: Only 1.28 is seen and 1.10 is never seen then M/s Doordarshi Pvt. Ltd. buys the CHF form the bank @ 1.2009

Scenario 4: 1.28 is never seen and 1.10 is seen, then M/s Doordarshi Pvt. Ltd. buys the CHF @ spot

Risk: The risk in the structure is that USD/CHF touching 1.10 levels, if that was seen, then M/s Doordarshi Pvt. Ltd. was open to USD/CHF exchange risk on maturity

The company leveraged its position and entered into various structured USD/CHF deals with various authorized dealer on the same underlying, as their intention was to gain from the market movement.

Outcome of Deal 2 and other Similar Deals

Subsequently on 23rd November 2007 the USD/CHF pair touched a low of 1.0896 thus triggering the 'Knock Out' leg of the embedded option structure. The second leg of the embedded option structure being 'Knock In' structure with trigger @1.28 was not triggered as the levels were never seen during the deal period. On maturity the USDCHF was @ 1.0170 and the company was under obligation to Buy CHF @1.0170 against USD.

The company did not have any export receivable in CHF.

Further the USD purchase cost against INR had also gone up as the USD/INR rate which was @ 40.170 on 01st of August 2017 had also gone up due to Rupee's depreciation and was @43.290 on 15th July 2008.

Similarly in other deals also, as the CHF never touched the knock-In levels but have touched the knock-out levels, so the company was open to market risk and has to buy CHF from the market to meet its obligation. Further, the situation had become worse as the company did not have requisite underlying to deliver because of excess leveraging and had to buy USD from the market against INR and company suffered heavy losses as Rupee had also depreciated significantly.

Further to add to its trouble, the company subsequently received a notice from Income Tax department for re-assessment of their P&L as the company had shown the Loss from derivative as business loss thus reducing the profit for the year by that amount and eventually its Income tax liability. Income tax department was of the view that the losses was due to speculation and not a business loss and thus, the company was not eligible to reduce the profit by adjusting the losses on account of these transactions and was liable to pay the taxes on full amount.

Section II
Learning from the Case Study

The above case study is based on the derivative debacle taken place during 2006-2010 in India. The company which initially gained some benefit on account of derivative deals, entered into exotic derivative structures to earn some profits without taking care of the underlying exposure, resulting in heavy financial losses due to adverse market movement of the foreign currencies.

Understanding the deal-2

Part 1: POS – Principal Only Swap

M/s Doordarshi Pvt. Ltd. to Buy USD 0.625million and Sell CHF @1.2009 (0.7505)

So M/s Doordarshi Pvt. Ltd. would have to buy CHF form Market to sell under the deal @1.2009 for eventual buying of USD

Also, the company was also having gain in form of interest carry of 1.40 per cent received on USD notional of 0.625 million

Part 2: Barrier Options – Knock Out

American K/O is @1.10 for structure "Buy USD PUT CHF Call @1.2009 for USD 0.625 million": This structure gave the company the right to 'Sell USD' and 'Buy CHF' @1.2009 for USD 0.625 million if USD/CHF did not touch level 1.10 during the period of the Deal. The CHF bought on maturity would have enabled the company to deliver under the derivative POS deal under which company has taken obligation to sell CHF @1.2009 and BUY USD.

But if the level 1.10 was to be seen any time during the deal period (as it is an American option), the above structure would have ceased to exist (K/O; Knock Out) and company will be open to market rate for buying CHF to deliver under the POS derivative deal on maturity.

American Exercise: It can be exercised any time from the date of entering the contract till date of maturity.

European Exercise: It can be exercised only on the fixed maturity date.

Example: Assume USD/CHF is at 1.05 than the company would have to buy CHF 0.7505 from market by paying USD 0.7147 million and then use the CHF to fulfill the POS structure obligation of selling it @1.2009 thus resulting in a loss of USD 0.0897 million.

Part 3: Barrier Options- Knock In

American K/I is @1.28 for structure "Sell USDCALL CHF PUT @1.2009 for USD 0.625 million": Under this deal, the structure would come to existence (K/I; Knock In) if the USD/CHF was to touch 1.28 anytime during the period of the deal. Company would be under obligation to sell USD and buy CHF @ 1.2009 only. This structure restricts the company to take advantage of the depreciated CHF against USD. In this structure had the CHF depreciated from 1.2009 but did not touch 1.28 than, the company would have been able to buy CHF cheaper from market and deliver under the POS deal.

Example: Assume USD CHF did not touch the 1.28 levels and was trading at 1.27 on maturity than the company would have bought CHF 0.7505 million from market by paying only USD 0.591 million, which would have been used to deliver under the POS deal, resulting a profit of USD 0.034million on exchange gain in POS over and above the Interest carry of 1.40 per cent.

If the USD/CHF pair could have touched 1.28 any time during the deal period than company would have been under obligation to buy the CHF from the bank @1.2009, which would have been used to deliver under the POS, thus no profit on POS other than the interest carry of 1.40 per cent which it was receiving on USD notional of 0.625 million

Section III
Total Loss on Account of Deal No 2

On the date of deal i.e. 01.08.2007	On the Maturity date i.e. 15.07.2008
USD INR was @ 40.170	USD INR was @ 43.290
USD CHF was @ 1.2009	USD CHF was @ 1.0170

(a) On the date of deal, the company has to buy USD 0.625 million and sell CHF 0.7505million. So liability of the company @ 40.170 was at Rs.2,51,06,250.

(b) On the maturity of the deal, the company has to sell CHF 0.7505 million for which it had to buy the same from the market as it did not have any export receivable in CHF. So, it paid USD 0.7379 million @ USD/CHF 1.0170. For Buying USD 0.7379, it paid Rs 3,19,43,691.

(c) Thus a net loss on deal 2 in INR terms was Rs 68,37,441 (excluding the inflow on account of 1.4 per cent carry on the USD 0.625 million)

Section IV
The Greed and the Trap

The company was not having any exposure in CHF, despite of this, it moved into a deal where the same had taken obligation to sell CHF @ 1.2009 in anticipation that CHF would not appreciate much beyond this point (K/I levels of 1.10). Because, it had never breached the level of 1.10 in the past for many decades. So, the company was aiming for a safe interest carry of 1.4 per cent on the USD Notional which would have helped it further to reduce its funding cost.

The initial motivator was the little gain from 1st deal. But the key difference between the 1st and the 2nd and subsequent deals was the underlying exposure. The company was not having any exposure in CHF and despite of this, it had moved to CHF liability, in anticipation of positive market movement.

USD/CHF graph for the relevant period

The USD/INR graph for the relevant period

Section V
The Points to be Discussed are

(a) The company used same underlying for multiple transactions. What were the relevant RBI instructions in this regard?

(b) What were the cause for CHF appreciation and Rupee depreciation during the period under consideration?

(c) Can the exposure be treated as speculation and subject to Income tax department scrutiny or it is a normal business transaction?

(d) What were the RBI guidelines in this regard?

1. The company had used the same underlying for multiple transactions. What were the relevant RBI instructions in this regard?

   Derivative transactions were permitted only for hedging of the underlying exposure and leverage was not allowed by RBI. The relevant instructions were in place vide Master circular on Risk Management and Inter-Bank dealing dated 04th April 2003 and in subsequent updated versions, published at yearly intervals. Further vide comprehensive guidelines issued by RBI through notification no DBOD No. BP.BC. 86/21.04.157/2006-07 dated 20th April 2007, hedging was allowed for purpose of risk mitigation and not for speculation.

2. What were the causes for CHF appreciation and Rupee depreciation during the period under consideration?

   In any market the exact cause of fall and rise of any commodity/underlying cannot be ascertained with hundred percent confidences but to some extent the following points can be attributed towards the rise of CHF

   - ❑ US Sub Prime crises, which was the result of housing bubble coupled with credit default swaps, resulting in worsening of financial condition and sentiments.
   - ❑ CHF being traditional safe-haven currency the inflow had increased, resulting in appreciation of Swiss Franc.

3. Can the exposure be treated as speculation and subject to Income tax department scrutiny or it is a normal business transaction?

   If the exposure is backed by underlying than it is a trade based hedging but if the underlying is less than the exposure taken in derivative, than the resultant gap should be treated as position taken for speculative purpose and the resultant gain and loss should be accounted in suitable manner, as it will not be a business loss. Thus, the company was not permitted to claim it as loss from business activity and was liable to pay tax on the higher component.

4. What were the RBI guidelines in this regard?

   RBI had issued comprehensive draft guidelines vide notification DBOD No. BP.BC. 86/21.04.157/2006-07 dated 20th April 2007, which permitted the need based hedging with use of proper instruments. The relevant points of the guidelines were as under:

   - ❑ Following products are permitted for exchange rate exposure: Foreign currency forward, Currency swap, currency options
   - ❑ Customer appropriateness and suitability policy
   - ❑ Following information needs to be shared with user

1. Description of the transaction
2. Building blocks of the transaction
3. Rationale along with appropriate risk disclosure
4. Sensitivity analysis identifying the various market parameters that affect the product
5. Scenario analysis encompassing both the possible upside as well as the downsides

   - ❑ Analyze the expected impact of the proposed derivative transaction on the user
   - ❑ Board approved policy,
   - ❑ Details of documentation (ISDA, etc)

Section VI
Trainer's Note

Teaching Plan

Topic	*Case study on derivative*	
Programs/sessions in which it can be administered	Risk Management (Financial Risk, Market Risk, Operational Risk, etc)	
	Derivative	
	Financial Statement Analysis (to focus on impact of leverage)	
	Program on Forex Dealings	
	Program on Markets (Equity/forex/Interest rate etc)	
No of Session	Two	
Target Group	Bank/Corporates working in treasury related areas	
Objective/ lesson can be drawn	To understand the Impact of excessive leverage	
	Impact of decision making without having proper understanding	
	Impact of timing the Markets	
	Importance of adhering to Regulatory guidelines.	
	Importance of Mark to Market/Stop Loss	
	TOPIC	*Time (Indicative)*
	Introduction	10 Min
	Section I to be given to participants and should be advised to go through it.	25 Min
	Participants will be divided into 4-5 group as per strength and advised to interpret the case and to present to the class	40 Min
	Section II to be given to participants or illustrated by the faculty	20 Min
Session Plan	Participants were advised to work out the loss on account of this deal	25
	The Solution should be discussed by the Faculty and distribute the Section III to participants to check their solutions	20
	Section IV and V should be discussed with the participants and can be handed over to them after discussion	20
	Sum-up all the learning form the case study	20
	Total Time	**180**

Learning Objective

The case study gives an insight into the following aspects

1. Excess leverage can result into unwanted results.
2. Underlying is a must for risk mitigation and any view and position taken without underlying will be speculation.
3. Markets cannot be timed.
4. Banks'/Authorized dealers are prohibited from financing speculative activities.
5. Understanding of a product is very important and a decision/position taken without understanding the consequences of the decision/position can result into significant trouble, both for the customer as well as the financer.
6. Regulatory guidelines need to be adhered to in true spirit.
7. Risk management is a must, irrespective of whether it's a customer or a Bank.
8. Mark to Market and Stop Loss concept is to be properly followed so as to avoid such huge losses.
9. Appropriate products depending upon the risk appetite and the understanding level of the customer should be provided that too with full disclosures.
10. Customer appropriateness and suitability of the product needs to be checked before offering any structured products.
11. The company's interested in dealing in derivative should have a risk management policy in place and Authorized dealers should allow only after obtaining all the approvals from the company like Board Resolution, Risk Management Policy, ISDA documentation etc.
12. The deal ticket should contain possible scenario analysis in user friendly language, so that the customer will be in a position to interpret it properly.
13. The dealing officials should be updated on the regulatory guidelines so as to avoid falling on the wrong side of the instructions issued by regulators.
14. The company board should take the review of the position from time to time and should not leave the deal in anticipation of positive results.

Introductory questions

Q. What is derivative?

Derivative is a financial instrument:

(a) Whose value changes in response to the change in a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index, or similar variable (sometimes called the underlying)

(b) That requires no initial net investment or little initial net investment relative to other types of contracts that have a similar response to changes in market conditions; and

(c) That is settled at a future date

Q. What is Currency Swap?

It is a financial contract between two parties exchanging or swapping two different streams of cash flow in different currencies.

Q. What is Option?

Currency option is a contract where the purchaser of the option gets the right but not the obligation to either purchase (Call Option) or sell (Put Option) and the seller of the option has an obligation to sell (Call option) or purchase (Put Option) an agreed amount of a specified currency at a price (Strike price) agreed in advance and denominated in another currency on a specified date (European Option) or by an agreed date (American Option) in the future.

Q. What is Knock In?

It is a barrier option; it means the structure will come into existence only when a predetermined price level is reached before expiration.

Q. What is Knock Out?

It is a barrier option; it means the structure will cease to exist if the predetermined price level is reached before expiration.

Q. What are the different types of risks in derivatives?

Credit Risk: Risk of failure of counterparty to perform its obligation

- Pre-settlement risk: Counterparty defaulting on a contract during the life of a transaction.
- Settlement risk: Counterparty defaulting in performing its obligation after one party has performed its part on the settlement date of the contract.

Market Risk: Risk of loss due to adverse movement in the market value of the underlying.

Regulatory Risk: Failure to comply with the regulatory requirements

Legal Risk: Loss from contract which are not legally enforceable.

Operational Risk: Risk of loss occurring as result of failed or inadequate systems and controls.

Liquidity Risk: Risk of mismatches of cash flows.

Q. What could be the impact of excessive leveraged position?

A leverage position will reduce the loss absorbing capacity of the corporate and if the position is big one and the things does not go as per corporate's wish than the results could be devastating.

Discussion Areas

1. Different types of risk in derivative transaction and effective risk management.
2 Corporate Governance
3. Regulatory guidelines on derivatives
4. Excessive Leverage and its consequences.
5. Importance of Market to Market and Stop Loss mechanism

Suggested Reading

No particular reading for the case but in general the following can be referred to

1. RBI Master circulars on Risk Management and Interbank Dealings/FEDAI Guidelines
2. RBI Circular on Comprehensive Guidelines on Derivative/FEMA
3. Book on Foreign Exchange, International Finance and Risk Management by A.V. Rajwade
4. Book on Currency Exposures and Derivatives: Risk, Hedging, Speculation and Accounting-A Corporate Treasurer's Handbook.
5. International Swap and Derivative Association's Guidelines and Documents.

Direct Marketing V/s Referral Marketing: A Case Study of a Co-Operative Bank

Ms Mauli S Bodiwala

This case study introduces the participants to various marketing strategies adopted by one of the largest multi state co-operative bank of Gujarat. It enables to understand how a co-operative bank which was started by food grain merchants has expanded its operations by providing best services to its customers. It highlights importance of Relationship banking. It describes typical culture of co-operative bank, desire of management to bring professionalism, recruitment of professionals, insistence of management for implementation of aggressive marketing strategies etc. It also highlights implementation of Direct marketing strategy and Referral marketing strategy in the bank, its pros and cons and its results. It also describes how satisfied customers as well as retired staff of the bank despite being senior citizens succeeded in canvassing more business as compared to young professional marketing team.

Keywords: Marketing of banking services, Relationship banking, Direct marketing, Referral marketing, Marketing strategy

Methodology

This case study is based on exploratory research. Data has been collected through meeting with Directors, Executives, Branch managers and other staff of the bank. Period of study is 2 years. (i.e. From the year 2014 to 2016).

Introduction

Indian banking industry has undergone a major transformation during last few years. Entry of new generation private banks in India increased competition among banks. Those days are gone when customers used to visit bank frequently to obtain services. In recent scenario, banks are required to arrange meeting with prospective customers, understand their requirements and devise products/services accordingly. Private banks are aggressive in use of information technology for delivery of banking services. Nationalized banks have adopted marketing approaches for meeting competition and varied demands of different consumer groups. In such a competitive environment, it becomes essential for Co-operative banks to adopt aggressive and progressive marketing approach.

Case Facts

About Bank

The Kalupur Commercial Co-op. Bank Ltd. (KCCB) is a Multi-State scheduled co-operative bank established in 1970. It is one of the largest co-operative banks in Gujarat having 40 branches. Total business mix of the bank was Rs. 7000 Crores in the year 2015.

Ms Mauli Bodiwala (maulibodiwala@gmail.com) Chief Manager, The Kalupur Commercial Cooperative Bank Ltd., Ahmedabad.

History

Bank was started by three founders, Mr Vijay Patel, Mr Baldev Patel and Mr Sahdev Patel who were engaged in food grain trading business at Kalupur area of Gujarat. Since these founders felt that businessmen are avoided by nationalized banks for convenient, easy and speedy credit, they started a bank in 1970 in the small room of Kalupur area to cater needs of Grain Merchants. Bank was headed by different General Managers who were not professionals but had good knowledge of basic banking and had good contacts with grain merchants of Ahmedabad. All these General Managers had good sense to judge customers and had ability to maintain relations with customers. They insisted more on relationship based banking. "Customer is GOD" was the only principle followed by staff of the bank. Bank focused on providing best customer service to its customers. There was no marketing strategy adopted by bank as bank insisted more on satisfied customer base and not on large customer base. Bank always insisted for long term relationship with its customers. There were no targets given to staff. Flexibility was given to staff in order to balance their personal and work life. Staff was much satisfied with work culture and had cordial relations with other staff members as well as with customers. Every year, bank declared 12 per cent dividend and a gift to shareholders. Bank organised various events like blood donation camps, Senior citizen day, health awareness programmes, yoga day etc. and invited its customers and shareholders. Bank insisted more on customer retention and obtained more and more business from existing customer base only.

Existing Management

About Directors

In 2015, there were 12 directors, including two professional directors (One CA and one experienced banker of Bank of India). Most of the other directors, including Chairman of the bank were only graduate and had experience of food grain trading business.

About General Manager

In 2015, Existing General Manager Mr Mahesh Patel retired and directors of the bank recruited new General Manager Mr Vishal Sheth who was young, energetic and experienced banker for last 20 years.

About Other Staff

Bank recruited Marketing Manager, Mr Hemant Shah who has done MBA(Marketing) and has 25 years of banking experience in public sector bank. Bank also recruited new CA, CS, MBAs, etc. as they wanted bank to be run by professionals and to adopt the culture of Nationalised/Private sector banks.

Vision

In the year 2014-2015, Directors of the bank had vision to expand their operations by expanding branch network, to increase customer base and to increase business mix.

Bank had planned to open five new branches at Surat, one at Mumbai and one at Ankaleshwar and increase branch network to 47 branches and reach business mix to Rs. 10,000 Crores by 2016.

Services of the Bank

- Term & CASA deposits
- Trade & Retail Advances
- ATM/ NEFT/ RTGS/ Pan card/ ASBA Services
- Locker facility
- Stamp franking etc.

Financial Position

Table 1
Actual Financial Data of the Bank as on 31.03.2014 and 31.03.2015

(Rs. in crores)

	Actual position as at 31.03.2014	*Actual position as at 31.03.2015*	*Growth in FY 2014-15 as compared to FY 2013-14*
DEPOSITS			
CASA deposits	850	1000	18%
Fixed deposits	2780	3250	17%
ADVANCES			
Business Advances	1740	2050	18%
Retail Advances	580	700	21%
Business Mix	5950	7000	18%
C/D Ratio	64%	65%	

Source: Modified data from The Kalupur Commercial Co-operative Bank Ltd.

Management of the bank observed that during the F.Y. 2014-15, there was overall growth in range of 17 per cent – 20 per cent in deposits and advances.

At the time of preparing budget for F.Y. 2015-16, bank observed that due to recession, most of the corporates/firms were in stagnant stage so it was difficult to increase bank's business advances portfolio which was main bread and butter for the bank. Management of the bank thought to decrease interest rate on deposits but since other banks have kept the rate intact, bank was not able to do the same. "How to increase business mix as well as profitability of the bank" was the major concern for the bank. Therefore, bank changed its focus to increase low cost deposits i.e. its CASA portfolio and also planned to focus more on Retail advances portfolio and prepared target as mentioned below:

Table 2
Actual Financial data of the bank as on 31.03.2015 and Target for FY 2015-16

(Rs. In crores)

	Actual position as at 31.03.2015	*Target for year 2015-2016*	*Projected growth %*
DEPOSITS			
CASA deposits	1000	2050	105%
Fixed deposits	3250	4050	25%
ADVANCES			
Business Advances	2050	2550	24%
Retail Advances	700	1350	93%
Business Mix	7000	10000	43%
C/D Ratio	65%	64%	

Source: Modified data from Kalupur Commercial Co-operative Bank Ltd.

Management advised General Manager to prepare a marketing plan to increase CASA deposits and Retail advances and above mentioned target.

General Manager, Mr Vishal Sheth arranged a meeting of branch managers, Head office executives to discuss ideas to increase CASA advances as well as Retail advances. Marketing Manager, Mr Hemant Shah devised a marketing strategy and proposed following marketing plan.

(Phase I – Period 01.04.2015 to 30.09.2015)

Marketing Strategy

Mr Hemant Shah insisted more on direct marketing. He believed that team of young, energetic and professionals can do marketing efficiently and deliver desired results. He insisted more on communicating customers through variety of media like text messaging, email, websites, online advertisement, database marketing, brochures/ leaflet distribution, targeted television/ radio advertisement, etc. He focused more on CASA deposits and believed that once customer opens account with bank, he/she will approach the same bank for retail loan so this will result in increase in retail advances also. He proposed following plan.

- Introduction of zero balance women savings account.
- Introduction of premium and privilege savings/Current account where customers needs to maintain minimum balance of Rs. 25000 and Rs. 50000 respectively. Such customers will be offered different benefits like no cheque issue charges, no RTGS charges, etc.
- All staff members are given target to open minimum 20 savings accounts and 15 current accounts per month and contact customers through telecalling/text messaging etc.
- A special team of four people who are young and energetic is to be formed and must be completely engaged in marketing activities. All the four persons are required to make 200 calls to unknown persons and send mails mentioning details of various products and services of the bank. Data of such prospective customers is to obtained from telephone directory/purchased from database companies. The marketing staff is

required to visit atleast 10 offices and 20 residential houses located near to branches and convince them to open accounts with bank. They must be given a target to insist customers to avail retail loans from bank.

- Marketing by distribution of brochures and leaflets mentioning benefits of premium and privilege accounts, type of retail loans and interest rates to all offices and residences located near to the branches.
- Marketing by giving advertisement in newspaper as well as radio advertisement.
- Marketing by preparing a video mentioning history, management, branch network, products, services, staff strength etc. of the bank which can work as marketing tool.
- Organizing "CASA Mahotsav" competition among branches to open maximum CASA accounts and increase Retail advances. It is proposed that branches that open maximum accounts will be offered monetary benefits.
- Arranging a marketing campaign at newly opened branches and distributing leaflets of bank.
- To start marketing with use of social media like facebook, twitter, google + etc.

Total budget cost for the said marketing plan was Rs. 25,00,000. Management felt that budget is on higher side but Mr Hemant Shah explained to the management that major cost of the budget was Radio and video advertising which was necessary to create awareness about bank to the public at large and this will ultimately result in increase in CASA deposits and Retail advances.

Management of the bank approved marketing plan along with budget and decided to observe results within a time period of 6 months.

Implementation of Marketing Plan and its Results in Phase I

- Branch managers insisted to open more and more woman savings account with Zero balance. Some managers celebrated women's day, mother's day etc. and canvassed woman savings account. Managers got good response in various celebrations as women were attracted to attend such events. This resulted in increase in number of women savings accounts. But after 3 months, branch managers observed that since these women were housewives, most of the accounts were inoperative. So there was only minor increase in CASA deposits.
- Managers as well as marketing staff canvassed rigorously to open premium and privilege current/savings account. But since other private banks were offering the same benefits with lower minimum balance, the said schemes were not successful.
- Entire staff of the bank started to make cold calls to unknown persons after banking hours. They also tried to visit nearby residences and offices. A special marketing team consisting of 4 persons made 200 calls to unknown persons and also visited various offices and residential houses. Since existing staff increased their efforts for marketing, it affected daily operations and service provided to existing customers. Bank did not get much response from cold calls as most of the people were already tired of such telephone calls from various banks and most of the customers were not even ready to listen about details of banking products and services. Bank did not get much response from visit to near by residences and offices as most of the people were already having current account and savings account with one or the other bank and they did not have much trust on co-operative banks.

- Bank distributed brochures and leaflets all offices and residential areas near to the branches. This resulted in increase in awareness about various products and services of the bank. Bank also gave advertisement in newspaper as well as radio advertisement. Due to this brand name and goodwill of the bank increased. Punch line of the bank "Kalupur Bank, apli potani bank" got popularity but majority of customers have much trust and confidence on their existing nationalized banks/private banks. So there was not much increase in CASA deposits as well as retail advances.
- Bank prepared a video mentioning history, Management, branch network, products, services, staff strength etc. of the bank and used the same as marketing tool to increase advertising of the bank.
- Bank also arranged "CASA Mahotsav" where competition was held among branches to open maximum CASA accounts and increase Retail advances. Staff insisted existing customers to open more accounts and to canvass new accounts. Existing customers were already having accounts of family members with the bank. Since there was no incentive scheme offered to such customers for giving reference of their friends/ relatives, there was no response from such customers.
- Bank started marketing campaign at newly opened branch. Marketing team distributed leaflets and visited near by residences and offices but this did not result into increase in customer base.
- Bank became active on social media like facebook, twitter, google +. This resulted into increase in awareness about various products/services of the bank but most of the users of social media were young persons who were more interested in internet banking solution which was not provided by the bank so ultimately there was no increase in CASA deposits/ Retail advances.

At the end of Phase I i.e. after 6 months, bank observed actual results which are as follows:

Table 3
Actual Financial Position of the Bank as on 31.03.2015 and as on 30.09.2015

(Rs. in crores)

	Actual position as at 31.03.2015	*Actual position as on 30.09.2015*	*Increase in Phase I (from 01.04.2015 to 30.09.2015)*
CASA deposits	1000	1100	100 (10%)
Fixed deposits	3250	3500	250 (8%)
Business Advances	2050	2150	100 (5%)
Retail Advances	700	800	100 (14%)
Business Mix	7000	7800	800 (11%)
C/D Ratio	65%	66%	

Source: Modified data from The Kalupur Commercial Co-operative Bank Ltd.

Management of the bank was quite disappointed to observe results as CASA deposits of the bank increased by only 10 per cent and Retail advances increased by only 14 per cent. Despite of making huge marketing expenditure of Rs. 26,00,000, bank was not able to achieve desired results. Management called a meeting of executives and Branch managers and invited suggestions to increase CASA deposits and Retails advances in Phase II.

(Phase II - Period 01.10.2015 to 31.03.2016) Shift from Direct Marketing to Referral Marketing Strategy

During the meeting, Ex General Manager of the bank insisted management to focus more on Referral marketing rather than focusing on Direct marketing. He gave an idea to form branch development committee at each branch. The said committee will be formed of reputed customers of the respective branch as well as retired employees of the bank residing in nearby area of the branch. He suggested that the said committee members will be responsible for sourcing of business for the respective branch through their own references. He emphasized to focus more on senior citizens to be appointed as committee member. He believed that such old customers will have sense of belongings and trust for the bank. Such customers will refer their friends, relatives and business concerns to get associated with bank. Such satisfied customers can enhance trust of prospective customers and will have spare time which they can devote for marketing of banking products and services. He also believed that if such senior citizens are offered some incentives/ rewards based on number of accounts canvassed, this will be good source of income for them and they will be motivated to work hard. Initially, directors of the bank appreciated idea of referral marketing but they opined that marketing of banking services through senior citizens is not a good idea and it will not result in achievement of target. But management thought to advise branches to invite application from existing customers to become committee members and then after looking to the response, decided to take decision. All branches invited existing customers to become committee members and work for the bank. While receiving the application, bank observed majority of customers who were senior citizens and were retired to be much interested in becoming committee members. This could be because these people visit the branch frequently and have good relations with staff of the bank and have positive feelings about the bank. Retired staff of the bank who resided in near by area of the branch also agreed to be become committee members. So finally, management took decision to go ahead with Referral marketing strategy. Branches formed Branch development committees in which most of the committee members were in age range of 60-70 years.

Bank called a meeting of branch development committee members and invited suggestions from them to increase CASA advances as well as retail advances of the bank. A revised marketing plan was proposed based on suggestions received in these meetings.

Revised Marketing Plan

- As per the plan, branch managers as well as staff of the bank must focus on providing prompt service. Branch development committee members will be engaged in marketing of banking services. The said committee members will canvass business from their own friends/relatives and business associates. For giving reference for each account, committee members will be offered incentives. Committee member will be responsible for canvassing the account, obtaining required documents, ensuring compliance of rules and regulations, filling up forms, solving queries by bank and providing any sort of assistance to customer.
- Bank encouraged its existing retired staff to canvass for CASA deposits and retail advances.
- "Family account" concept is to be introduced in the bank, in which all the members of the family are required to open savings account with bank and the said accounts will be known by family name. All CASA accounts, retails loans obtained by the said family members will fall within "Family account". Such accounts will be given priority while processing advances/opening of accounts. There will be one relationship manager

who will take care of requirement of such account and will visit customer at regular intervals and will know their requirement. Each family account is to be rated in the month of October (After obtaining income tax returns/financial statements) based on family income, their networth , past record etc. Preferential rate of interest will be provided to "Family account" based on rating to be allotted. At the end of every F.Y., Relationship manager will collect income tax returns/financial statements of all family members latest by October and bank will update family income in their own database and will revise rating of the "Family account". During the year, at any point of time, if any member from the said family wants to avail any loan, he/she needs to submit only minimal data to the bank as financial statements, history, rating allotted to the family account is already available to the bank. This will reduce paper work for customers as well as bank.

- Benefit of 20 per cent discount in locker rent for first 6 months is to be offered to new premium and privilege account holders.
- A small gift in form of " Water bottle/Tiffin" to be distributed to all depositors and borrowers of Ankaleshwar Udyognagar Co-op. Bank which was merged with KCCB. The main intention behind the same is to invite existing customers at the branch and make them aware about bank, its various products and services. Staff must insist such satisfied customers to canvass business for bank and refer more clients.
- For newly opened branches at Surat, staff to focus more on Micro credit advances and cater needs of embroidery workers, diamond cutting workers etc. Bank also planned to start mobile van catering to needs of under privileged and unreached poor people.
- For newly opened branches, bank is required to purchase property or take property on lease and also needs to contact with newspaper agencies, advertising agencies etc. While dealing with such intermediaries, Branch manager must explore possibility of canvassing business from such persons or through their references.

Implementation of Revised Marketing Plan and its Results in Phase II

- As existing customers were given a chance to become branch development committee members, it created a sense of belongingness in them and they felt themselves to be a part of the bank. This feeling encouraged them to do rigorous marketing for the bank. Since most of the committee members were senior citizens, they had spare time to devote time for such marketing. These senior citizens canvassed bank's products at their various get together groups. They arranged a marketing campaign at various public gardens where they used to go for walk. They also marketed various products of the bank in their religious groups. While visiting temples, they encouraged trust of the temple to put deposits with the bank and open accounts. Since they themselves had good experience with the bank, they shared their experiences with prospective customers. They helped prospective customers in filling up the forms and ensured them good service and no hidden charges.
- In some of the instances, friends/relatives of committee members were facing problems for obtaining loan from other banks as they had less CIBIL Score, average credit worthiness or only one year income tax returns was available. Since Committee member knew such customers personally, they took up responsibility of repaying loan on behalf of such customers and due to such assurance, bank provided retail loans to such needy and genuine customers. Since these customers were able to obtain loan from the bank in timely manner and without much hassle, they opened family accounts with bank and also referred their other friends/relatives. So customer base of the bank increased through referral marketing and such customers were delighted with services

of the bank. Such customers appreciated efforts of committee members which strengthened their relationship and increased their goodwill. Committee members earned commission which helped them to be financially independent. Committee members focused more on retail loans and such customers opened savings account with bank which ultimately resulted in increase in CASA deposits as well as retails advances.

- Retired staff of the bank canvassed for CASA deposits and retail advances. They already had knowledge of banking products and services, so it was easy for them to do marketing of the same. They had good contacts with existing customers so they approached them and insisted them to give reference of atleast 5 customers. They arranged campaigns at various schools and colleges regarding basic knowledge of banking products and services. During the campaigns, they insisted students to open savings account with bank and obtain education loan from the bank. They also arranged parents meet and insisted parent to opt for "Family account". Retired staff approached corporate clients of the bank and insisted them to open salary account of their staff with the bank. They also emphasized on opening family account for such staff. Due to long term cordial relations of corporates with retired staff of the bank, bank could open many salaried accounts which got converted into family accounts. Slowly and gradually, family members of such staff approached bank for various retail loans as they preferred to obtain all banking services only from one bank. So ultimately, initially CASA deposits of the bank increased and this resulted in increase in retail advances. In addition to that retired staff earned commission on each such account and felt satisfied to be associated with the bank once again.

- Staff of the bank insisted existing customers to opt for "Family account" and explained them benefits of such account. They explained them various benefits of "Family account" and obtained savings accounts of all family members. Initially, this increased operational level work of the staff as they had to obtain income tax returns of all family members and allot rating to the family account. But once rating was allotted, it became easy for staff to evaluate eligibility of retail advances and provided loans to such customers within few hours.

- Since bank offered benefit of 20 per cent discount in locker rent for first 6 months to new premium and privilege account holders, many customers opened such accounts and maintained minimum balance of Rs. 25000 to Rs. 50000. With the said scheme, bank was able to sell vacant lockers increase CASA deposits as well as obtain increase in bank’s locker rate income.

- Ankaleshwar branch announced to provide gift to depositors and borrowers subject to fulfillment of KYC compliance. A special officer was appointed to provide information about background and history of KCCB, various products and services of bank to customers with the help of videos and presentation. By getting free gift, customers were delighted and their trust for the bank increased. Such customers shared news of free gifts and services of the bank to their friends and relatives which helped bank to increase publicity in new region i.e. Ankaleshwar. Footfalls in the branch increased and this resulted in increase in CASA deposits and Retail advances.

- Bank started a mobile van which was working in two shifts. With the help of such mobile van, bank could cater various localities of Surat region. Bank approached various embroidery workers, diamond cutters, vegetable vendors etc. and insisted them to cultivate habit of savings. Bank opened savings accounts for these people. After observing conduct of the account for three months, bank offered them micro credit advances to the extent of Rs. 25,000 with interest rate of only 10 per cent. By helping such needy people, bank fulfilled its corporate social responsibility and its reputation and status increased.

- In the Ankaleshwar branch, bank has distributed gifts of `Varmora` brand. During purchase of such gifts, branch manager of Ankleshwar branch visited factory of `Varmora` brand and took over its all credit facilities from its existing bank and provided business loan at a competitive rate of interest. Bank also opened 150 salary accounts of entire staff of `Varmora` brand and insisted them to opt for `Family account` scheme.
- Bank purchased premises from Ajmera Group of Builders at Mumbai for its newly opened branch. During the purchase procedure, Branch manager developed good relations with the said builder and provided him lease rent discounting facility of Rs.1000.00 Lakhs for its another project. Bank also opened 200 salary accounts of entire staff of `Ajmera group`. Employees of the Ajmera group approached bank to avail retail advances. The main promoter of the `Ajmera group` was made committee member and he canvassed more business for the bank through his personal references.
- Bank made a policy for various intermediaries associated with bank (like paneled advocates, paneled valuers, paneled stock auditors, Asset management companies etc.) to open current account with bank and make all payments to them in the said current account only. Due to this, CASA deposits of the bank also increased.

At the end of Phase II i.e. after six months, Management observed that there has been significant increase in CASA deposits and Retail advances. The bank could attain business mix of Rs. 9550.00 Crores which is near to target. Total marketing cost incurred for Phase II was Rs. 7,00,000 which was mainly commission paid to committee members, retired staff.

Comparative Position of Results of Phase I and II

Table 4

Comparative Financial position of the bank in Phase I and Phase II.

(Rs. in crores)

	Actual position as at 31.03.2015	*Actual position as on 30.09.2015*	*Increase in Phase I from 01.04.2015 to 30.09.2015)*	*Actual position as on 31.03.2016*	*Increase in Phase II (from 01.10.2015 to 31.03.2016)*
CASA Deposits	1000	1100	100 (10%)	1950	850 (77%)
Fixed Deposits	3250	3500	250 (8%)	3900	400 (11%)
Business Advances	2050	2150	100 (5%)	2450	300 (14%)
Retail Advances	700	800	100 (14%)	1250	450 (56%)
Business Mix	7000	7800	800 (11%)	9550	1750 (22%)
C/D Ratio	65%	66%		63%	

In Phase I, bank was far away from its target. Growth in CASA deposits was only 10 per cent and in retail advances was only 14 per cent which was quite unsatisfactory. Bank was also not able to achieve increase in Fixed deposits as well as Business advances.

In Phase II, there was drastic increase in CASA deposit i.e. 77 per cent. Retail advances of the bank increased by 56 per cent which is also satisfactory. Bank could achieve results which were quite nearer to target for FY 2015-16. (Refer Annexure I for further details along with graph.)

Annexure I

Figure 1

Comparative Position at End of Phase I and Phase II

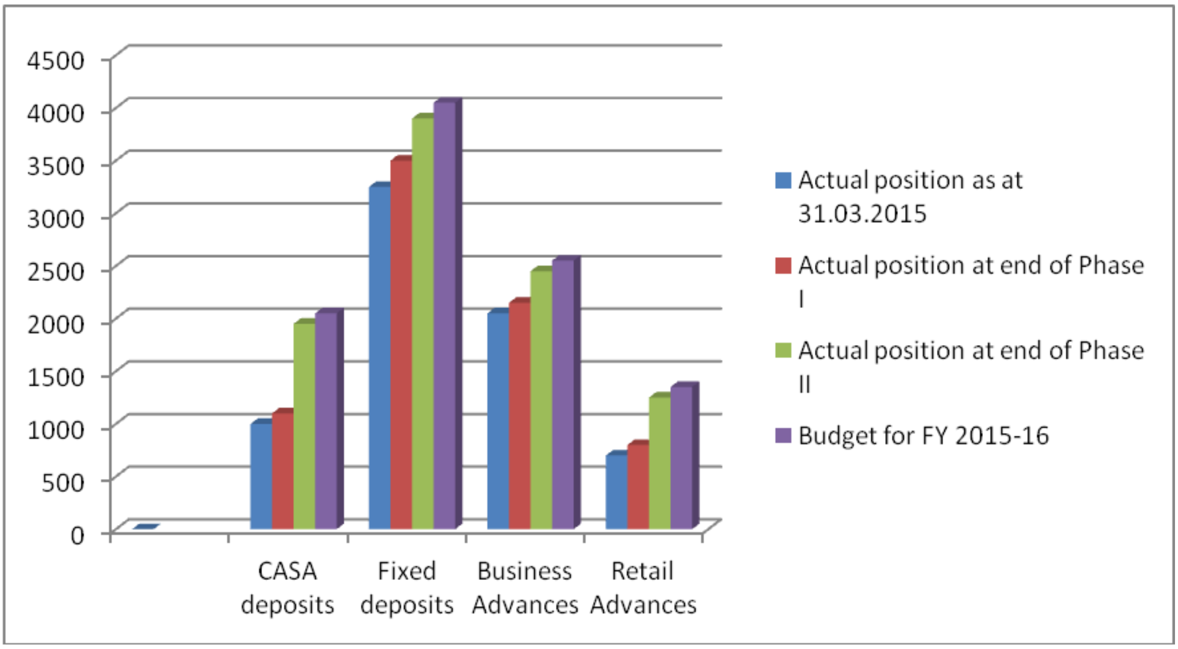


Table 5

Comparative Position at End of Phase I and Phase II

(Rs. in crores)

	Actual position as on 31.03.2015	*Actual position at end of Phase I (As on 30.09.2015)*	*Actual position at end of Phase II (As on 31.03.2016)*	*Budget for FY 2015-16*
CASA deposits	1000	1100	1950	2050
Fixed deposits	3250	3500	3900	4050
Business Advances	2050	2150	2450	2550
Retail Advances	700	800	1250	1350
Business Mix	7000	7800	9550	10000

Annexure II

Figure 2

Comparison of Actual Marketing Expenditure Incurred in Phase I and Phase II

Actual Marketing Expenditure Incurred

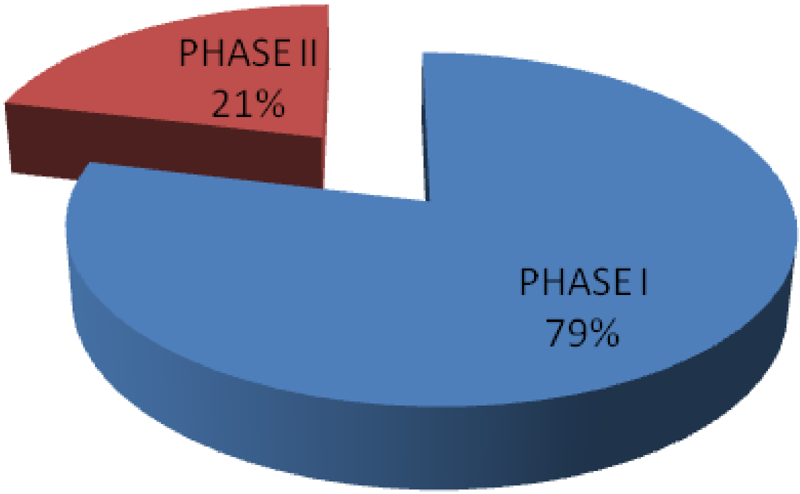


Table 6

Comparison of Actual Marketing Expenditure Incurred in Phase I and Phase II

Phase I

Type of marketing expenditure	*Amount in Rupees*
News paper advertisement	350000
Video advertising	950000
Radio advertising	1000000
Leaflet/ brochure advertising	200000
Commission paid	50000
Others	50000
TOTAL	2600000

Phase II

Type of marketing expenditure	*Amount in Rupees*
Gifts	80000
Commission paid	600000
Others	20000
TOTAL	700000

References

1. Marketing Management, 14th Edition, Kotler, Phillip and Keller, Kevin Lane. (Second impression 2014) By Pearson Education Inc.
2. Principles and Practice of Banking, (Second Edition, 2008) by IIBF
3. www.kalupurbank.com

Direct Marketing *V/s* Referral Marketing:
A Case Study of A Co-Operative Bank
(Category: Marketing of Banking Services)

Teaching Note

I. Synopsis

II. Learning Objectives

III. Prerequisite Conceptual Understanding (PCU)/Before the Classroom Discussion

IV. Case Positioning and Setting

V. Assignment/Introductory Questions

VI. Classroom Orchestration

VII. Analysis of Discussion Areas

I. Synopsis

The premise of this case study is to enable a discussion on culture and marketing approach of co-operative bank. The discussion highlights various marketing strategies adopted by the bank. It also highlights problems faced by the bank while implementing strategy, reasons for success and failure of each marketing strategy. It describes pros and cons of each marketing strategy. It also covers importance of sales force and steps in managing sales force effectively. It also highlights steps for effective selling.

II. Learning Objectives

1. To understand the importance of relationship banking, concept, of Direct marketing and Referral marketing and its pros and cons.
2. To discuss and debate marketing plans implemented by bank, its results and reasons behind its success and failure.
3. To discuss the importance of sales force and steps in managing sales force effectively. To understand steps for effective selling. To understand how satisfied customers/ staff can contribute effectively for marketing of products/services.

III. Prerequisite Conceptual Understanding (Pcu)/Before the Classroom Discussion

The students/participants should be encouraged to read the following to generate a meaningful discussion and adequate analysis of this case study.

Kotler, Philip and keller, Kevin Lane, Marketing Management, 14th Edition, Pearson publications, 2014.

Chapter No: 1 Defining marketing for 21st century, and Chapter No: 18 Managing personal communications.

IV. Case Positioning and Setting

This case study can be used in MBA, Executive MBA or Executive development programme, for the topic "Marketing of banking products or services":

Sub topic: "Direct marketing *v/s* Referral marketing"

To understand participants various marketing strategies, its implementation, its results and its prons and cons.

V. Assignment/Introductory Questions

1. What do you understand by relationship banking? How bank has expanded its operations from one branch to forty branches without implementing any aggressive programme marketing strategy? From the case facts, can you establish any one dimension of Holistic marketing (Relationship marketing, integrated marketing, internal marketing, performance marketing.)
2. Which marketing strategies were adopted by bank in Phase I and Phase II? What are the features of these strategies, difficulties in implementing the same. According to you which marketing strategy was successful and what are the reasons behind its success? (Direct marketing and its various tools and Referral marketing)

3. Whether selection of proper sales force and managing sales force in effective way results into achievement of targets or not? How sales force is to be selected and managed?
4. What steps are taken by bank for effective selling? (Major steps for effective selling).
5. Whether higher marketing expenditure results into achievement of targets or not?

VI. Classroom Orchestration

Exhibit (TN) - I: Classroom Orchestration

Analysis Segment	*Holistic Marketing dimensions*	*Various Marketing strategies*	*How Sales force is to be selected and managed?*	*Steps for effective selling*	*Marketing expenditure*	*Wrapping up/ Debriefing*
Relevant section of the study	About bank	Phase I and Implementation of marketing plan in Phase I , Phase II and Implementation of revised marketing plan in Phase II				
Anchor point discussion	Relationship marketing, internal marketing, integrated marketing, Performance marketing	Direct marketing, Referral marketing, Societal marketing, Word of mouth marketing, Tele marketing etc.	Selection of proper sales force and managing sales force	6 Step process of selling	Marketing expenditure	
Discussion points	How bank expanded its operations by implementing relationship marketing. Features of Relationship banking and its benefits	Which strategies were implemented by bank? What was its features and why it failed or succeeded?	How bank selected proper sales force? What were qualities of such sales force? How bank managed these sales force?	How bank succeeded in getting business from effective sales person?	Whether high amount of marketing expenditure results in achievement of target or not?	Learning outcomes from the discussion
Expected learning outcomes	At end of this section, participants should be able to understand all four dimensions of Holistic marketing (especially relationship marketing)	At end of this section, participants should be able to understand marketing strategies, its pros and cons.	At end of this section, participants should be able to understand importance of selection of proper sales force and how to manage sales force.	At end of this section, participants should be able to understand 6 Step process of selling.	At end of this section, participants should be able to understand importance of marketing expenditure.	
Duration	5 minutes	25 minutes	10 minutes	10 minutes	5 minutes	5 minutes

Source: Author

VIII. Analysis of Discussion Areas

Exhibit (TN) - II : Relationship marketing

Relationship marketing aims to build mutually satisfying long term relationship.

Customer	"Customer is God" was the principle followed by bank. Bank insisted more on satisfied customer base and organised various events to be associated with customers. Distribution of dividend and gift delights customers/stake holders.
Channels and partners	Since staff of the bank was satisfied, they maintained co ordial relationship with customers and provided best service to them. Even though no targets were given to staff, staff worked hard and helped bank to achieve its milestones.
Conclusion	Staff including General Manager and directors of the bank were not professionals, no marketing strategy was implemented but insistence of relationship banking helped bank to expand its operation from one branch to forty branches and become one of the largest co-op. Bank of Gujarat. Satisfied employees can perform well as compared to employees who are under pressure to achieve targets. Distribution of gifts to shareholders/customers enhances bank's reputation and delights them.

Source: Author

Exhibit (TN) - III : Various Marketing strategies applied in Phase I and Phase II

Phase I (Direct Marketing)

Introduction of Zero balance Woman savings account	Increase in Women CASA accounts do not result into CASA deposits. Bank should have targeted such customers who do maintain sufficient balance in CASA accounts. Bank should decide target customer and then implement marketing strategy.
Introduction of premium and privilege savings/current account scheme	Bank introduced premium and privilege savings/current account scheme which was not competitive as compared to other banks' scheme. Bank should study competitors' schemes and then plan its own scheme which has distinguished features.
Telecalling/emails/SMS to unknown persons and visit to near by offices/residence without having appointment. (Tele marketing/Email marketing/SMS Marketing)	Bank gave target to staff to make calls to unknown persons and visit nearby offices and residence which interrupted privacy of public and response from such efforts was very low. Most of the emails and SMS were ignored by customers. This being a co operative bank, new customers had no trust on the bank. So Tele marketing/Email marketing/SMS Marketing could not give required results as there was lack of trust.
Distribution of Brochures and leaflets, News paper and Radio advertisement, video advertisement	This resulted into increase in goodwill and brand name of the bank. Tag line of the bank became popular due to radio advertisement. Such type of marketing helps bank in long term. But since customers had trust on other banks, this did not help bank in achieving targets.
Insistence to existing customers to canvass business from their friends/ relatives in CASA Mahotsav	Bank insisted existing customers to canvass for business from their friends/relatives but did not offer any monetary benefit to customers. Therefore there was no response from customer. Bank should have insisted on partner relationship management and should have offered incentives to such customers for canvassing business.
Marketing campaign at newly opened branch	Since customers at newly opened branch had no experience of bank, marketing efforts made there could not provide desired results.
Social media marketing	Bank started marketing on social media which is mainly used by young persons who were more interested in e banking and had preference for private banks.
Due to above reasons, Direct marketing strategy of the bank was failed and could not give desired results even after incurring high amount of marketing expenditure.	

Source: Author

Phase II (Referral Marketing)

Marketing efforts by branch development committee members (who are existing satisfied customers)	Bank formed branch development committee of existing satisfied customers and engaged them as sales force to canvass business for bank. Most of these members were senior citizens, had long term association with bank and cordial relations with staff. Since these members have trust on the bank and sense of belongingness, they extend their wholehearted efforts. They shared their own experiences with prospective customers and convinced them. Such members communicated bank services to public at large. They ensured their support in filling up forms, giving guarantee on behalf of customers, follow up with bank employees etc. Since members were given monetary benefits for canvassing business, they increased their marketing efforts. Such commission/incentives helped these members to be active in their old age and also helped them to be independent. Satisfied customers are long term assets of the bank and they give benefits to the bank by referring the bank to their friends/ family members.
Marketing efforts by retired staff of the bank	Retired staff of the bank was aware of customer base, products and services of the bank. Bank engaged them as sales force and gave them opportunity to become independent and once again work for bank. They took advantage of their relations with existing customers and convinced them to give reference of prospective customers.
Family account concept – One step solution for whole family	Bank observed problems faced by its customers and devised a specific product, hassle free procedure, one stop solution for all family members by bringing "family account" scheme. (One stop solution for all products/services)
Concessional in locker rent to premium/privilege account holders	Bank provided concession in locker rent to premium/privilege account holders. The said benefits were not offered by other banks. (Devise a scheme which is competitive/attractive as compared to competitor’s scheme.)
Distribution of gift	Bank distributed gifts to depositors/borrowers of "Ankaleshwar" branch. Since customers were delighted they canvassed about bank’s products to their relatives/friends and created awareness about bank among public. Word of mouth marketing is an effective marketing strategy.
Micro credit advances and introduction of mobile van	Bank started mobile van and started giving micro credit advances. This enhanced their image in public and also encouraged under privileged persons to become independent as part of its corporate social responsibility. Societal marketing helps society at large and increases brand image of organisation.
Canvassing business through channel partners/ intermediaries	Bank canvassed business advances from supplier of gift, seller of branch premises and increased CASA deposits as well. Canvassing business through its channel partners/intermediaries is also effective way of marketing.

Source: Author

Exhibit (TN) - IV : Comparative study of selection of sales force in Phase I and Phase II

	Phase I	*Phase II*
Recruiting and selecting sales representative.	Bank recruited young team for marketing but they were new to bank and had no sense of belongingness for bank. They were under pressure to meet targets. They were not aware about problems faced by customers of the bank and their requirements.	Bank appointed existing customers and retired staff of the bank as sales representative. Both of them had good relations with existing staff of the bank and had complete knowledge of services.
Training sales representatives	Bank recruited young team for marketing but no specific training was given to them. There was only one way communication from management to staff. Opinion of staff regarding how to market products, problems faced by them etc. was not discussed.	Committee members were already having knowledge about products/ services of the bank so there was less need of training. Bank also invited suggestions from them and implemented them which helped bank in achieving targets.
Supervising sales representatives	There was no supervision on sales representatives.	Sales representatives were offered commission which was linked to their canvassed business, so every month bank was able to supervise performance of sales representatives.
Motivating sales representatives	Bank arranged competition for branches to open CASA accounts but no monetary benefits were offered to individual staff. Due to these, sales representatives were less motivated and were under pressure of work.	Sales representatives were offered monetary benefits linked with their performance. Their association with the bank increased their goodwill. They become financially independent. Due to all these, they were quite motivated and worked hard for bank and helped bank to achieve targets.
Evaluating sales representatives	Bank evaluated performance of sales representatives by sales reports generated, through personal communications, customer letters etc.	Bank evaluated performance of sales representatives by number of accounts canvassed by them and commission given to them.

Source: Author

Exhibit (TN) – V : Steps taken for effective selling in Phase II

Prospecting and qualifying Pre approach	Committee members targeted schools, trusts etc. as their prospective customers. They also targeted existing customers to give reference of their friends/relatives who can be prospective customers. Bank also identified their suppliers, channel partners, distributors as their prospective customers and approached them to open CASA accounts and canvass retail advances.
Presentation and demonstration	Committee members shared their experiences to prospective customers. Bank displayed video advertising while distributing gifts at Ankaleshwar branch.
Overcoming objections	Bank offered discount in locker rent to make premium/privilege account scheme successful. Committee members helped customers in filling up forms, follow up with bank and other procedural aspects. They also provided guarantee for repayment for genuine customers.
Closing	Continuous follow up by committee members with staff helped bank to open accounts rapidly and bank provided advances in timely manner. Family account scheme also helped account holders to obtain finance within few hours only and also helped in getting benefit of lower rate of interest based on rating allotted.
Follow up and maintenance	Relationship manager appointed for "family account" continuously followed up with account holders to know their requirements, problems faced by them etc. This enhanced trust of account holders towards bank.

Source: Author

Exhibit (TN) - VI : Comparative study of Marketing expenditure incurred in Phase I and Phase II

Phase I	Bank incurred total marketing expenditure of Rs. 26,00,000. Major portion of the same is Radio and video advertising. This expenditure helped bank in increasing brand image but could not help bank to achieve results. Rather than incurring fixed expenditure, bank should have insisted more on variable expenditure linked with sales performance. It is not necessary that higher marketing expenditure always produces desired results.
Phase II	Bank incurred total marketing expenditure of Rs. 7,00,000. Major portion of the same is commission paid to sales representatives. Bank could achieve its targets with lesser marketing expenditure.

Source: Author

Digital Tools for Preventing Frauds in Corporate Loans

Shri Gautam Kumar

Banking industry is undergoing a big digital revolution. This space of ever changing technology is motivating the banks to build & serve their corporate clients with a strong & user-friendly fraud protection system. Finding a niche between the opportunities and risks will only require an innovative approach to prevent the corporate fraud. Leveraging machine learning and advanced analytics to minimize risks and, hence, can prove to be the winning strategy for fraud prevention especially in corporate loan fraud.

Reserve Bank of India (RBI) data, shows that state-run banks have reported 8,670 "loan fraud" cases totaling Rs. 612.6 billion over the last five financial years up to March 31, 2017.

Technology is like a double-edged sword, which can be used to perpetuate, detect and prevent frauds."

Keywords : Asset Quality Management, Loan Fraud Prevention, Corporate Loans, Digital Tools

Introduction

The Indian banking industry has no parallels in the banking history of any country in the world. After independence, the banking sector has passed through three stages: character-based lending to ideology-based lending to competitiveness-based lending."

What is needed instead is a combination of checks from a layered approach that banks will have to adopt

Technology can play a major part in combatting new age frauds, some techniques such as data visualization have proved to be effective. Fuzzy logic is another technique, which can be used on the data records of a company. These clubbed with a social network analysis, can indicate possible threat of collusion. Progressive reviews of unstructured data can help banks analyze the sentiments, tones and elements described in the fraud triangle (incentive, pressure and rationalization).

Learning Objectives

1. What is present scenario regarding corporate loan fraud?
2. What are the various digital tools? (Like CERSAI, MCA21, CIBIL, EQUIFAX, CRILIC, SFMS, etc.)
3. How to prevent corporate fraud using Digital Tools?
4. How digitally monitor the behavioral/biometric aspect of big ticket size borrower?

Shri Gautam Kumar (gsagar6@gmail.com) Senior Manager & Faculty, Bank of Baroda, Baroda Academy, Vadodara

Case Background

ABC bank is continuously facing the incidents of corporate loan fraud. Mr Ram has newly joined the zone as zonal head. The data shows that the corporate loan fraud massively grew in few years. Thus, this impacted the bottom line and the bank is facing the reputational risk as well as credit risk.

Mr Ram was invited for a meeting with the CEO, the GM audit, inspection and vigilance, GM Large Corporate. The CEO has given the task to take preventive measures to stop the corporate loan fraud in the zone

The GM (A & I, Vigilance) provided the data of corporate fraud. These fraud have been kept publishing in the media.

Mr Ram has taken it as challenge and his one point agenda is to analyse :

1. Past corporate frauds
2. Lapses and observations made
3. Preventive vigilance for averting the corporate in future
4. To spread awareness among staff and arrange training for credit officers on topic: Fraud prevention.

Mr Ram discusses the issue with the four regional managers and various marathon meeting was hold, paper work, desk work, field research has been done. Some sample cases were taken into account for learning point so that the staff handling the corporate loans should be aware.

Mr Ram read a long and worthy article in a popular financial newspaper that some foreign banks are using Artificial intelligence and digital tools for prevention of "Corporate Loan Fraud".

This gave him a trigger to know, what the digital tools are:

1. Our bank is using to assess a big corporate loan portfolio.
2. What could be other tools that can be used to catch early warning signals?
3. Which Digital tools and Artificial intelligence platform are available to verify the borrower genuineness, project related facts, financials, business related aspects etc.
4. Can we know or assess the behavioral aspect/character/integrity of the borrower through digital monitoring?

Mr Ram went through some past corporate loan fraud cases of his zone.

Sample cases/incident of corporate frauds are as below:

Brief of Case 1

M/s DDLL is a public limited company incorporated in 2009. The company is north India based and the promoters are engaged in trading iron and steel for last 10 years.

The company is dealing with the RRR Bank since 2010. The company was doing well and flourishing. The promoters approached RRR Bank for credit facilities. The company was willing to set up a steel plant under multiple/consortium banking.

Looking to the the business potential, future prospect and the financial of the company, various credit facilities were sanctioned under Consortium banking arrangement and RRR bank was a leader of the consortium.

Details of the credit facilities sanctioned to the company by RRR **b**ank :

Sr. No.	*Nature of Facility*	*Amount Sanctioned Rs. in Crores*
1.	CAPEX Loan/Term Loan (for setting up the plant)	45.00
2.	Cash Credit (For pre and post working capital finance)	23.00
3.	Packing Credit (Sub limit of Cash Credit)	(6.00)
4.	Import LC	190.00
5.	Bank Guarantee	92.00
6.	Forward exchange	3.50
7.	Total	390.50

There are frequent break downs in the factory. The company has not met the deadlines of setting up the plant and got delayed.

The steel plant defaulted in repayment of installment and interest in term loan and it is not giving satisfactory reply for the bank's follow up for repayment of loan.

There were no genuine business transactions between the said firm and shell companies. The said firm also allegedly diverted Rs. 376 crore (approx.) out of the Working Capital Limit obtained from consortium of banks to six wholly-owned foreign subsidiaries based in Singapore, Hong Kong, Dubai, Indonesia, Ghana and China

Observations/Lapses

- It was observed that the company is raising Accommodation Bills
- Transactions in the account not thoroughly checked by the branch which led to diversion of fund.
- The firm was also dealing with other bank
- Frequent invocation of BGs and non-payment within a reasonable period
- Prima facie, the purpose of opening these accounts was specifically to make the foreign remittances and not for carrying out any other business as there were hardly any other normal business transactions in these accounts
- Alerts were raised by the system in terms of Exceptional Transactions at Branch but they were overlooked or bypassed by the branch.
- The machineries were not physically verified by the bank officials and it was found that the machineries purchased not as per quotations submitted at the time of sanction.
- Bills under LCs are mostly dated next day of LC issue which was not noticed.
- Banks/branches were not prudential in monitoring of account - market intelligence, sharing of information among banks.

Brief of Case 2

The company, FFF Pvt. Ltd. primarily engaged in processing of Basmati rice and other cereal products was sanctioned a limit of Rs. 75.00 crores by the bank on 01.06.2013. The fund based component of loan is Rs. 70.00 crores and Rs. 5.00 crores.

Later, the company formed a consortium arrangement of various banks where the ABC bank is the leader. The exposure of other banks is165.00 crores. In June 2015, the company defaulted its obligation to service interest and installment. The company has informed that it is facing severe liquidity crunch and cash flow mismatch.

In spite of allowing some time, the company could not improve business. Then, the company requested for SDR option as corrective action plan. As per requirement of SDR scheme, special investigative audit in the account was carried out by the bank.

In JLF meeting, it was decided to have further investigation before taking a view on the account. Accordingly, Forensic audit was allotted to M/s PPP Associates. The forensic audit report was submitted to JLF which declared the account as fraud.

Forensic audit report reveals the following:

- ❑ The company included stock of damaged paddy and grains for availing drawing power.
- ❑ The company is maintaining multiple ledger accounts of the same parties across various godown/locations.
- ❑ Huge difference was observed between information reported in the stock statement and books of accounts of the company.
- ❑ Debtors squared off with the unrelated creditors. This practice resulted into "Non realization of Debtors" and understatement of creditors to the member banks.
- ❑ Company transactions were concentrated with a group of companies wherein the entities were having common directors.
- ❑ The company squared off substantial amount of outstanding debtors with purchase under 2 way trade transactions with the same entities.

Brief of Case 3

SME Loan Processing Centre has sanctioned a cash credit of Rs. 15.00 crore to a private limited company M/s BBB Pvt. Ltd., against equitable mortgage of 8 properties. There are three directors in the company. All are living very lavish life and also engaged in property dealing. After one year, the turnover in the account began to decline and the account became NPA.

Out of eight properties, three properties were valued of Rs. 5.00 crore and belong to another company M/s XXX. Another property belong with a value of Rs. 1.10 crore belong to M/s YYY Company.

The four properties belong to the borrowing company M/s BBB Pvt. Ltd. and value of these four properties is at Rs. 8.90 crore.

When notices issued, one of the guarantors claimed that documents signed as guarantor and KYC and ID proofs were fabricated.

While carrying out the legal audit, it is found that three properties belonging to the borrowing company M/s BBB sold out by the directors without the knowledge of the bank.

Lapses and Observations

- On investigation, it is found that two properties is already charged to other banks.
- And equitable mortgage done in the bank on the color xerox.
- The inspection of the property is not done properly before sanction. A very casual visit report was there which is signed by a junior level officer.
- CERSAI search was not made.
- The search report from the advocate was ambiguous which was accepted by the branch or ignored the comments of the advocates.
- The Bank has not taken the latest receipt of water tax, house tax and it was found that it was pending to pay.
- The online checking of property on revenue/land portal has not done.
- KYC due diligence has not observed.

Assignment to Participants

Participants to be asked the following questions:

1. What are the digital tools for assessing or gathering information about the corporate borrowers?
2. How bank guarantee/LC related fraud can be averted?
3. How to verify the various documents submitted by corporate borrower digitally?
4. What are the strategies you suggest to overcome the situation in future?
5. Suggest the Innovative Digital interventions for processing the large corporate proposals including deviations, alert, etc.
6. What are the preventive measures while financing against properties? How digitally verify the property related documents and genuineness?

Facilitator Note/Trainers Note

Case Administration Methodology

The participants may be divided in a group of 3-4 persons each and ask the group elect a Group leader.

Each Group to identify and enumerate the grey areas as visible to them in the entire case which possibly led to the lapse.

Ask the Group leaders to share the areas that have emanated out of the discussions within the group.

The Case administrator may write down all the points shared by the Group leaders so as to arrive at all the gray areas that exist in the case.

Facilitator to give the suggested solutions as follows:

Solution (1)
Digital tools for assessing or knowing the corporate borrowers

1. To obtain CIBIL report, we should have unique ID of the borrower/guarantor
2. One such method is income tax website
3. Visit https://incometaxindiaefiling.gov.in/e-Filing/Services/KnowYourPanLink.html
4. Enter date of birth of the borrower and his name in the required field that will give his PAN Card number.
5. Then obtain latest CIBIL report of the account which provides his latest address, contact number, e-mail address, employment status etc. by putting user ID and password for CIBIL report purposes already with the Branches.
6. The report will also give the last date of enquiry by the borrower/other Financial Institutions. The address available in the CIBIL report may be crosschecked with Social media like face book, twitter, LinkedIn etc. for being doubly sure that the person under reference is the required borrower
7. Please call on all the numbers shown in CIBIL report.
8. Please crosscheck from the employer (obtained as above) that the person is employed with them.
9. The various details given on social websites like Face book , LinkedIn etc should be crosschecked from the details available in the file of the borrower, e.g. if the name of the school in the social site and in our file is same , there is very high probability that the person detailed in the social site is the same borrower.
10. After experimenting over a period of time the staff members will be more experienced in locating such untraceable borrowers with the help of CIBIL report and social websites.

Solution (2)
Digital Platform for Preventing Guarantees and Letter of Credit Fraud

SFMS, which was launched in 2001, is a secure and common messaging system for secure communication within a bank and between banks.

An LC is a letter from a bank guaranteeing payment for goods that a buyer purchases from a seller. By discounting of LC, a seller gets paid immediately even if the buyer has been given a longer term for payment.

A BG is a guarantee from a bank ensuring that the liabilities of a debtor will be met. In other words, if the debtor fails to settle a debt, the bank will cover it.

It is felt that making use of SFMS mandatory will help banks to establish a secure medium of transferring trade finance messages for sending and receiving LCs and BG instruments. This will establish a safe and secure environment in the Indian banking industry for conducting trade finance business. Though the SFMS platform is capable of handling non-payment applications like LCs and BGs in a secure and cost effective way, only a few banks are currently using it.

Once it is decided that a BG has to be issued, the same shall be issued on the SFMS platform. This message will be sent to the beneficiary's bank/advising bank through SFMS," said the ministry.

Emphasizing that the SFMS platform has demonstrated its resilience, security and scalability, the ministry observed that it has been successfully used by banks and some State governments for national electronic funds transfer.

Precautions for Issuing Guarantees

Banks should adopt the following precautions while issuing guarantees on behalf of their customers.

1. As a rule, banks should avoid giving unsecured guarantees in large amounts and for medium and long-term periods. They should avoid undue concentration of such unsecured guarantee commitments to particular groups of customers and/or trades.
2. Unsecured guarantees on account of any individual constituent should be limited to a reasonable proportion of the bank's total unsecured guarantees. Guarantees on behalf of an individual should also bear a reasonable proportion to the constituent's equity.
3. In exceptional cases, banks may give deferred payment guarantees on an unsecured basis for modest amounts to first class customers who have entered into deferred payment arrangements in consonance with Government policy.
4. Guarantees executed on behalf of any individual constituent, or a group of constituents, should be subject to the prescribed exposure norms.
5. It is essential to realise that guarantees contain inherent risks and that it would not be in the bank's interest or in the public interest, generally, to encourage parties to over-extend their commitments and embark upon enterprises solely relying on the easy availability of guarantee facilities.

Precautions for Averting Frauds

While issuing guarantees on behalf of customers, the following safeguards should be observed by banks:

1. At the time of issuing financial guarantees, banks should be satisfied that the customer would be in a position to reimburse in case the same are required to make payment under the guarantee.
2. In the case of performance guarantee, banks should exercise due caution and have sufficient experience with the customer to satisfy themselves that he has the necessary experience, capacity and means to perform the obligations under the contract, and is not likely to commit any default.
3. Banks should refrain from issuing guarantees on behalf of customers who do not enjoy credit facilities with them. As non-compliance of RBI regulations in this regard is likely to vitiate credit discipline, RBI will consider penalising the non-compliant banks.

Ghosh Committee Recommendations

Banks should implement the following recommendations made by the High Level Committee constituted in October 1991 (Chaired by Shri A. Ghosh, the then Dy. Governor of RBI):

1. In order to prevent unaccounted issue of guarantees, as well as fake guarantees, as suggested by IBA, bank guarantees should be issued in serially numbered security forms.
2. Banks should, while forwarding guarantees, caution the beneficiaries that they should, in their own interest, verify the genuineness of the guarantee with the issuing bank.

Internal Control Systems

Bank guarantees issued for Rs.50, 000 and above should be signed by two officials jointly.

A lower cut-off point, depending upon the size and category of branches, may be prescribed by banks, where considered necessary.

Such a system will reduce the scope for malpractices/losses arising from the wrong perception/judgment or lack of honesty/integrity on the part of a single signatory. Banks should evolve suitable systems and procedures, keeping in view the spirit of these instructions and allow deviation from the two signatures discipline only in exceptional circumstances.

Precautions to be taken in the Case of Letter of Credit

Banks should not extend any non-fund based facilities or additional/ad-hoc credit facilities to parties who are not their regular constituents, nor should they discount bills drawn under LCs, or otherwise, for beneficiaries who are not their regular clients. In the case of LCs for import of goods, banks should be very vigilant while making payment to the overseas suppliers on the basis of shipping documents. They should exercise precaution and care in comparing the clients. The payments should be released to the foreign parties only after ensuing that the documents are strictly in conformity with the terms of the LCs.

There have been many irregularities in the conduct of LC business, such as the LC transactions not being recorded in the books of the branch by officials issuing them, the amount of LCs being much in excess of the powers vested in the officials, fraudulent issue of LCs involving a conspiracy/collusion between the beneficiary and the constituent.

In such cases, the banks should take action against the concerned officials as well as the constituent on whose behalf the LCs were opened and the beneficiary of LCs, if a criminal conspiracy is involved.

This can be digitally verified by ECGC portal etc.

Solution (3)
Digitally Verifying the Various Documents Submitted by the Corporate Borrower

At Application level	*Source/Website*	*Discussion Points*
Application in the Banks format to be obtained. Information provided in the application to be scrutinized and cross checked. The Genuineness of the information submitted to be satisfied upon missing information further required arriving at the credit decision to be sought and obtained.		Facilitator to discuss all important fields in the application and how the same can be verified.
For Verification of KYC of individual Borrowers: PAN Card Details	PAN No : incometaxindiaefiling.gov.in/	PAN No and name; Jurisdiction of filing in the SARAL can be verified.
Voter ID	http://electoralsearch.in/	Search can be made giving Voter ID No or Details can be given and voter id no obtained.
Aaadhar No.	https://uidai.gov.in/beta	In the website by giving AADHAR Number, we can see whether such number exists, gender, state, mobile number if any.
	EKYC can be done at the Branch	It is biometric verification through which full aadhar detail can be downloaded and verified.
Analyzing Networth	F135	Facilitator to ponder on the importance of analyzing and accepting the Networth Details.
Verification of Business data		
Registration certificate under Commercial Tax Officer	Can be verified from state websites, if available Alternately, GST returns submitted by the borrower to be verified by the empanelled agencies.	Eg., in Tamilnadu, http://www.tnvat.gov.in/ Tinsearch.htm TIN search/Name search can be done

At Application level	*Source/Website*	*Discussion Points*
For Companies – Preliminary Due Diligence For accessing Public documents to verify further data.	http://www.mca.gov.in/mcafoportal/viewCompanyMasterData.do http://www.mca.gov.in/MCA21/dca/WebHelp/How_can _I_ view_ public_documents_of_a_ Company_.htm	From the portal master data of the company, view of signatories, index of charges Details of associate companies(using DIN) The URL gives how to access Public Documents. Facilitator may use the same. (BS , DR ,CR data)
Preliminary Balance Sheet submitted	www.icai.org	Membership No and name of firm or the chartered accountant can be verified.
ITR Verification	ITR , computation and balance sheet filed can be verified through empanelled agencies.	
Credit Information Reports		
RBI Wilful Defaulters List	Available in intranet (under BCC page Large Corporate Banking) Also available SMA 2 List	Facilitator to Download the same and explain.
ECGC Caution List	https://www.ecgc.in/ ECGC ID and Password can be applied online through Bank's email and obtained.	Facilitator to demonstrate
CIBIL/EQUIFAX For consumer CIBIL – to be accessed with ID and password For commercial CIBIL	https://consumer.cibil.com/ https://commercial.cibil.com/CibilLogin.aspx Equifax is generated through LAPS	Facilitator to explain CIBIL in the light of the circular BCC:BR:108/277 20th June, 2016 Facilitator also to explain how the various addresses given in CIBIL to be co-related with the addresses given in the application.
Credit Report from Banks to For Takeover	Credit Report for the Borrowal entity and the sister concerns to be obtained and satisfied. Format of credit report for takeover of accounts.	
Statement of accounts (Group Discussion)	Original statement to be obtained and scrutinized thoroughly	Original statement to be obtained and scrutinized thoroughly. Any excess/TODs and when it was adjusted ; No. of times etc., to be analysed (If facilities with other Banks)

At Application level	*Source/Website*	*Discussion Points*
		Limit sanctioned and Drawing Power and interest detail – to be cross checked with details with Sanction letter and information obtained during discussion. Cross check the parties of Debit with the major Creditors Cross check the credits whether from purchasers (Debtor). Verify if debits not intune with the business are appearing and are regular. Verify if inter firm transactions are there and the extent of the same. Details and amounts of cheque returns to be critically analysed. Turnover in the account to be studied. Critically analyse the logo, format of statement, Dates whether chronological etc., Statements of sister concerns to be obtained and analysed.
Pre-Sanction inspection Report		In the light of details submitted – to be done independently with critical angle.
Market Report (Role Play)	Discrete enquiries on the entity from neighbors, suppliers of Borrowal entity, any of the person in the same/ similar trade, a friendly talk with the workmen of the borrowal entity during pre-sanction visit to disseminate information etc.,	
Google Search	Name of the company, associate, Director can be entered and search made to find any latest information available.	
Invoice verification	For Term Loans the Proforma Invoice submitted to be subject to scrutiny-discrete check on vendor, price, genuinity to be verified.	Facilitator to indicate the necessity of due diligence on the supplier, Whether the proforma invoice is valid as on date to be ascertained etc.,

At Application level	*Source/Website*	*Discussion Points*
		For Term loan, margin to be brought up front and disbursement to be made preferably including margins, directly to dealer and invoice obtained.
Other Approvals	Necessary approvals for establishment of the business including factory licence, building approvals, explosive licence is any, clearance from PCBs, etc., to be scrutinized.	Facilitator to discuss the importance of PCB approval Important licenses like fire and explosive license for dealing with explosive chemicals, Food license for edible items etc., The business will be illegal if the statutory approvals are not obtained. Facilitator to make the participants aware of the same.
Details of Property taken as security (To be touched - Detailed analysis during Documentation Session)	Legal opinion and valuation to be studied in tandem. Boundaries in both to be compared. Tracing the title to be scrutinsed to establish links. Boundaries in EC for which to be rechecked with Property boundaries. Critical examination of linear measurements and boundaries to be done to ensure the extant of land mortgaged and that no landlock or encumbrance is there. Pre-sanction inspection also to be corroborated with the above. www.cersai.org.in Online ECs and patta(khatha) in available in some states. Verification through online portals to be done wherever available.	Facilitator to impress on coverage on these points while doing pre-sanction inspection also. Facilitator to emphasize that pre sanction inspecting officer should also verify boundaries with the legal and valuation report and make independent enquiries on the ownership and valuation and to comment on the same. Inspecting officer should also make a sketch of the location. Photograph to be taken during inspection and attached to the inspection report. CERSAI search for any encumbrance on the property to be undertaken. Eg., in TN, www.tnreginet.net is website of revenue authorities wherefrom, the classification of the survey no (i.e, residential, agricultural, commercial etc.,) can be obtained, guideline value of the property can be obtained, online EC can be obtained from 1987 by giving survey no., on line patta ,if issued can be verified.

Solution (4)
The suggested measures for Prevention of Fraud

Detection of Incident

- The bank should have the ability to detect the fraudulent activity or identity or suspicious transactions, submission of fabricated documents etc.
- If the bank is not able to detect suspicious activity as it's happening, they'll likely be unable to prevent fraud before it materializes into a real threat.
- When it comes to keeping fraud at bay, therefore, robust detection is one of the first need to make sure regarding proper handling or scrutiny.
- The ability to detect fraud depends on having a detection solution in place - one that's built to comprehensively monitor transactions and other activities in real time, so that no questionable activity slips through the cracks.

Defense Mechanism

- The fraud detection is vital, but it's also important for the bank to have tools in place that provide defense against such attacks.
- These defensive methods should be built around securing all facets of a financial business, but particularly those that are most susceptible to intrusion.

Evolve

- The bank should follow the guidelines of regulators , Govt etc but also should evolve a robust fraud prevention strategy .
- This also includes Continuous training and learning, tools for generating alert etc.

Solution (5)

Suggestive Digital Interventions in processing/appraising the proposal, etc.

- There should be facility for digital application form of the corporate borrower so that all the relevant columns can be filled and easily cross- verify the details immediately

  (Impact: In manual application form, it is found that many informations are missing or filled in very casual way. If the application filled digitally the chances of wrong data or non-filling up data will be less.)
- The processing part must be digital there less manual interventions. The Processing software itself do some validations simultaneously.

List of Validations

- PAN card to be validated against the entity type and the forth character of the PAN
- Aadhar Number (EKYC)
- Based on the entity type (Individual/Non-Individual) - fields will be displayed.
- Corporate Identification Number
- Date of Incorporation
- If any unusual/abnormal data found Alert will be triggered
- If guideline differs, Deviation will be triggered.

- Mobility of Individual Location
- NRI status of Director
- Existing Buyers/ supplier

Some of the parameters for Scoring will be Auto fetched while others will be selected by user.

- Some of the parameters that are manually selected are:
  – Relationship with Bank
  – Designation
  – Stability of Income
  – Proof of Income
  – If Borrower/Guarantor is also a Guarantor for Someone Else
  – Type of Collateral (% of Liquid Security to Total Coll. Security)
  – Price volatility (to be scored for > 75% Liquid securities only)
  – Marketability (to be scored for > 75% of Immovable collateral only)

Financials Validation/Verification

- Balance sheet
- Profit & Loss
- Income tax returns
- GST returns
- Share price
- (High/Low)
- Stock & Debtors
- Vendor Verification
- Share holding pattern

Deviations Validations etc.

Deviation Norm	*Type of Deviation*	*Deviation Criteria*
Concession in ROI	Financial Deviation	Any change in the product define Rate of Interest. Concession in ROI will be allowed for the Entire Tenure in case of Term Loan and Demand Loan In case of Overdraft the concession will be allowed for a period of 12 months only or next review of the account or whichever is earlier
Concession in Processing Charges	Financial Deviation	Any kind of waiver/change in the processing charges (Including commitment charges and mortgage creation charge)
Age norm	Non-Financial Deviation	Less than Min and more than Max age for the define product will be deviation
Income	Non-Financial Deviation	As per the Eligibility Matrix Sheet
Income Multiplers (Increasing the No of times)	Non-Financial Deviation	Income less than the Min income required (Not applicable for Gold, Term Deposit, LIC, KVP, NSC and Pre Approved Limit Product)
Loan amount	Non-Financial Deviation	Exceding the maximum loan amount defined for the product. More than the Maximum loan amount can be exceeded to all the retail product
Repayment Period	Non-Financial Deviation	Any change in the product defined Maximum Repayment Period. Repayment Period deviation will be triggered in case difference of Maximum Age – Person Age more than the Repayment Tenure.
Job stability Norm/No of Years in the Business/Profession	Non-Financial Deviation	Experience less than the Min years of experience will deviate
Margin Norm	Non-Financial Deviation	Applicable. If the margin is changed and below the product margin Home Loan – No change in the Margin allowed
Valuation Norms	Non-Financial Deviation	If Market value is considered for the calculation
Age of Property	Non-Financial Deviation	If age of property is more than 25 years Applicable to product where property serves as security.

Deviation Norm	*Type of Deviation*	*Deviation Criteria*
CIBIL Norm	Non-Financial Deviation	Less than the Stipulated CIBIL cut-off score 725. Based on product wise CIBIL deviation matrix
FOIR/Repayment Capacity	Non-Financial Deviation	If FOIR ratio is more than the defined for the product
Existing Banking Relationship	Non-Financial Deviation	Less than Minimum banking relation with our bank or other bank
Citizenship	Non-Financial Deviation	If citizen of selected country list
Relationship with Applicant	Non-Financial Deviation	If Relationship with Applicant selected other than that defined for particular product and other parameter
Profit Deviation	Non-Financial Deviation	Product wise defined criteria
Overdraft Sublimit Deviation	Non-Financial Deviation	If Term Loan exceeds the maximum % of Overdraft define for that product
Ratios Deviation	Non-Financial Deviation	If the Proposal Type is chosen as a Takeover then Current Ratio: Minimum 1.17:1 Debt Equity Ratio: Maximum 6:1
Shareholding Deviation	Non-Financial Deviation	If the Shareholding % is less than 20%
Below Cutoff Score	Non-Financial Deviation	If the internal score for the product is below the cut off score then deviation should be raised. This will be applicable for both - applicant and co-applicant if co-applicant income is considered.

Solution (6)

Digital Safeguards to be observed for accepting the property as security

Central Registry of Securitization Asset Reconstruction and Security Interest of India (CERSAI)

CERSAI's initial mandate was to maintain a central registry of equitable mortgages, where it contains information on the equitable mortgage taken on a property along with details of the financial institution that has extended the loan as well as details about the borrower. CERSAI also allowed lenders to register transactions of securitization and asset reconstruction.

The CERSAI registry platform can be accessed online by financial institutions and the general public for a fee. However, the latter can only access information related to equitable mortgages.

This allows prospective lenders to check the registry to ensure that the property against which they are extending a loan to a borrower is not encumbered by a pre-existing security interest created by another lender. Even if it is, with details of the previous loan available to them, they can examine if the value of the collateral is sufficient for them to extend another loan, given the existing liability on the property. For the general public, especially for home buyers, it enables them to check the registry's records to ensure that any property they are planning to purchase, is free of any loan/security interest created by a lender.

According to the government's directives, financial institutions must register details of security interests created by them with CERSAI within 30 days of its creation

Online Revenue/Land Record Verification

Several states have their own official sites to verify the land records. These sites may be used for preventing loan fraud against properties.

1. For checking Mutation status.
2. To raise farm credit/loan from the Bank.
3. For Bank account opening.
4. To verify land title during sale of land and registration of property.
5. For division of land.
6. Personal purpose.
7. Legal purposes.

The websites for the verify the land records

Jharkhnad	:	http://jhr.nic.in/lrms
Uttarpradesh	:	http://upbhulekh.gov.in
Bihar	:	http://164.100.150.10/BiharBhumi/
Andhra Pradesh	:	http://registration.ap.gov.in
Gujarat	:	https://anyror.gujarat.gov.in
Maharashtra	:	https://mahabhulekh.maharashtra.gov.in/

Other Precautionary Measures

The search report from an empanelled Advocate should elaborately deal with scrutiny of records in respect of the property on which the flats/houses are constructed from the office of Sub-Registrar of Assurance and from the Records of Civil Court in the metropolitan Cities of Mumbai, Delhi, Kolkata and Chennai.

Before registration of the duly embossed and duly stamped documents/agreements with Registrar of Assurances, a search should be taken in the pending registry records to verify whether the same flats have already been mortgaged/encumbered.

While accepting properties for mortgage, it should be done only after taking physical search in sub registrar's office and land records concerned and all documents are required to be entered before Registrar of Assurances (ROA)

Builder's undertaking should invariably be obtained to the intent and effect that the flats/ houses intended to be sold to the intending purchaser are not agreed to be sold to any other person and he is agreeable to the bank's lien being noted in his records and books in respect of the flats/houses restraining the intending purchaser to sell mortgage or transfer in favor of any other person without the consent of the bank.

Original title deeds should be deposited with the bank. lt should be carefully noted that the copies of title deeds or extract of revenue records/property card do not constitute the title deeds nor an agreement for sale or a municipal order directing handing over the land and title deeds, for the purpose of creation of valid equitable mortgage.

Where the property to be mortgaged is a vacant land or "excess land" within the meaning of Urban Land Ceiling & Regulation Act, permission of competent authority should be obtained for creation of equitable mortgage, if the Act is still in force in the State where the property is situated.

Wherever Mortgage Security is created by a person on the strength of Power of Attorney (POA) before creation of Mortgage the POA should be got scrutinized by the Bank's Advocate/Legal Department to ensure that the requisite powers are contained therein.

lf the builder is a private limited or a public limited company, report from the office of Registrar of Companies should be obtained for ensuring that the entire property (in which flat proposed to be financed) is not charged in favour of any bank/financial institution/ other creditor for finance availed by the company.

Besides, valuation report submitted by govt./Approved valuer in respect of immovable property, the Sanctioning Authority should assess the value of the property independently to detect any over valuation of the property to avail excess finance or to avoid applicant's contribution towards margin. Integrity and market reputation of the valuer should be of high order.

Teaching material/Class Notes/Data

Digital Tools for Preventing Corporate Loan Frauds in Banks

1. CIBIL

- ❑ CIBIL Trans-union Score for individual – Consumer score ranges from 300 to 900
- ❑ Higher the score, the more confidence of the financial institutions in the borrower or ability to pay is more that means closer to 900 is good
- ❑ CIBIL reports:

  For Individuals – Consumer Credit Information Report

  For Non Individuals – Commercial Credit Report
- ❑ CIBIL report provides :

  Consumer History
- ❑ Probability of Default on the basis of history
- ❑ Loan repayment behavior

Credit Reporting: CIBIL offers comprehensive credit reporting solutions to banks and NBFC on the basis of highly predictive data used by the customer to arrive at the CIBIL status of the customer. This involves an in-depth analysis of a consumer's credit history, repayment patterns, etc. after which his CIBIL report is generated.

Fraud and ID Management: The ever-changing financial market makes it imperative for the organizations to keep a sharper eye on possible frauds.

The traditional risk management tools are not enough to detect fraud and inefficiencies in the modern world. CIBIL's Fraud and ID Management solutions assist the organizations in assessing risk and finding the right customers.

2. MCA21

Details pertaining to a registered entity or to be registered entity (Private Limited Company or LLP or OPC or Limited Company for which name approval application has been applied) can be accessed through the MCA Master Database.

- ❑ The following information pertaining to a registered business in India can be found from the MCA Master Data:
- ❑ CIN (Corporate Identification Number)
- ❑ Company Name
- ❑ ROC Information
- ❑ ROC Registration Number
- ❑ Company Category (Company limited by shares/Company limited by guarantee/ Unlimited Company) – Want to know more? About Types of Company.
- ❑ Company Sub-Category (Indian Government Company/Indian Non-Governmental Company)
- ❑ Class of Company (Public Company/Private Company)

- Authorised Capital of the Company
- Paid up Capital of the Company
- Date of Incorporation
- Address
- Email
- Listing Status
- Date of Last Annual General Meeting
- Date of Balance Sheet
- Company Status
- Charges Registered on a Company
- Charges registered on a Company are the interest or right which a lender or creditor obtains in the property of the company by way of security that the company will pay back the debt.
- Charges on a Company are usually raised when the Company or LLP raises bank loan or financial assistance from financial institutions.
- Date of Charge Creation or Modification
- Charge Amount
- Charge Holder
- Address of Charge Holder
- Signatory Details – Checking Directors of Company
- The list of Directors of a Company or Partners of a LLP can be found using the Signatory Details search functionality of the MCA Portal.

The following details pertaining to Directors of a Company or Partners of a LLP are available online:

- DIN Number Details
- Name of the Directors or Partners
- Address of the Directors or Partners
- Designation
- Date of Appointment
- Digital Signature

3. Structured Financial Messaging System (SFMS): Digital Platform for Bank Guarantee/LC

- The critical need for a secure and common messaging system that would serve as the basic platform for intra-bank and inter-bank applications and would fulfil the requirements of domestic financial messaging gave rise to the Structured Financial Messaging System (SFMS). SFMS was launched on December 14, 2001, at IDRBT.
- SFMS is like other global messaging systems, but is feature-rich and has more utilities. The major advantage of SFMS is that it can be used practically for all secure communication purposes within and between banks.

- The intra-bank part of SFMS can be used by the banks to take full advantage of the secure messaging facility it provides.
- Banks can develop comprehensive and efficient tools/applications, and integrate them easily with SFMS for use on the Corporate Intranet. Banks can link all their important, high volume branches to SFMS, irrespective of their category, through appropriate network connectivity. Moreover, use of SFMS is not restricted only to computerized or partially computerized branches.

4. Probe 42 (http://www.probeinformation.com)

- This site is to enable Indian businesses to make better business decisions through the use of information.
- It help in interacting with each other, reduce bad debt and improve efficiency.
- To put it in simple words, Probe42 is an online information platform that helps you make real-time business decisions.
- Information on private companies in India is mosaic in nature. Probe42 puts it all together, in one place, accessible to you from anywhere.
- Bankers/lenders can use the data for better decision and informations about companies.

5. Glass Door

- Glassdoor is a website where employees and former employees anonymously review companies and their management.
- It can give insight about the happening in the companies. The feedback of employees are very important tool to know the hidden face of any entity.
- Glassdoor ratings are based on user-generated reviews. Each year Glassdoor ranks overall company ratings.
- This is a great tool to know the review of company from his employees and outsider.

6. Commercial Trigger solution (Dynamic Monitoring)

- Dynamic monitoring of credit portfolio with commercial triggers is as portfolio monitoring service that helps to gain the insight of bank's borrower. CIBIL receives more than 1.80 lakh enquiries monthly on commercial lending space when a borrower looks for/avail additional facilities from other financial institution. Commercial Triggers ensure that our bank is instantly made aware.
- Credit Activity Triggers: New enquiry added to borrower:- This trigger instantly releases information about any enquiry that has been made for borrower seeking for a new facility in some other bank.
- Change in Asset classification Triggers: Trigger will provide information on change on asset classification with detail of credit type, amt.etc.

7. Digital Verification of Attestation of documents:-

- It was observed by ICAI that fake signatures of Chartered Accountants in practice were circulating all over India and this led to the question mark on our reputation and credibility.
- To remove this malpractice of attestation of documents, ICAI has issued UDIN number. UDIN stands for UNIQUE DOCUMENT IDENTIFICATION NUMBER.

- To tell you in brief, it is a unique number which will be generated for every document certified/attested by practicing Chartered Accountant and the attested document would be registered at UDIN portal, the link of which is https://udin.icai.org.
- As per the sources, this number will help to identify the fake documents, which are not attested by CAs.
- Major uses of UDIN would be: Universal Identification of certified documents It will help regulators/government to get authentic documents Traceability of fake and forged documents would be easy.
- More transparency and accountability Security of documents certified by Practicing CAs Establishes originality and authenticity of documents

8. Behavioral Analytics to Detect Fraud

- Banks are turning to web analytics data, such as behavioral data, but these same fraud prevention teams and companies are struggling with how to abstract meaningful insights that can be leveraged in their current fraud prevention platforms.
- The analytics system analyzes the repository of data which are used to detect patterns, anomalous behavior, and other intent signals that can provide actionable insights into both legitimate and fraudulent transactions.
- Fraudsters can and will exploit weaknesses which is why most banks turn to fraud prevention providers, having the expectation that their technology is outpacing that of the criminals perpetrating the fraud. It is important for businesses to partner with a provider that has the ability to identify and react to untapped data sources such as behavioral analytics.
- Behavioral analytics solutions are designed to understand the normal behavior of each individual account holder, calculate the risk of each new activity and then choose intervention methods commensurate with the risk.
- The key characteristics that make behavioral analytics effective are automatically monitoring all activity for every account holder in real-time, not just customers that convert.
- Business leaders and marketers have traditionally utilized behavioral data to optimize the user experience with the end goal of converting the user to a sale, failing to realize how the same data can also be used to identify fraudulent behavior on the website.
- By incorporating device intelligence and behavioral analytics, our software delivers accurate and reliable decisions letting you know whether to allow, review, or reject at the time of a transaction.

9. ECGC Portal

ECGC's SAL is merely a tool for the Corporation to monitor it's underwriting of the various borrowers of the bank customers of the Corporation.

Hence, the list is not released for public consumption.

The parties who are placed on the list are:

- The Borrowers whose defaults to the bank has resulted in reporting of the same to the Corporation.

- The persons behind the Borrowers whose defaults to the bank has resulted in reporting of the same to the Corporation.
- The Guarantors of the Borrowers whose defaults to the bank has resulted in reporting of the same to the Corporation.

The list is not a black list or avoid list. The list merely means that the Corporation will provide cover only on specific application, not automatically.

10. Equifax

Businesses are challenged with detecting increasingly sophisticated fraud attempts. Growing reliance on online channels and 'instant credit approvals' to increase revenues presents greater opportunities for skilled fraudsters.

Equifax offers effective solutions to fight synthetic and true-name fraud, along with real-time detection of velocity and behavioral patterns that are indicative of suspicious activity.

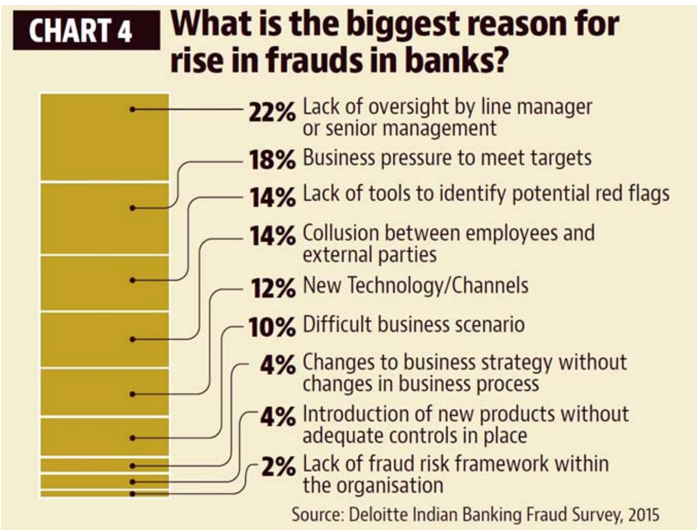
Equifax's vast repository of industry-leading data helps provide deep insight around consumer identities. Our assets include credit, employment, income, demographic, telecom, utility, device ID and other differentiated data sources. We provide advanced analytics and technology innovations to improve fraud capture rates and dramatically decrease false positives.

11. CRILIC

The limited and often untimely exchange of information across stakeholders did not provide enough time for corrective measures. With the recent boost to digital reporting, the situation has improved, but challenges around the efficiency of tracking and exchange of information is still a concern.

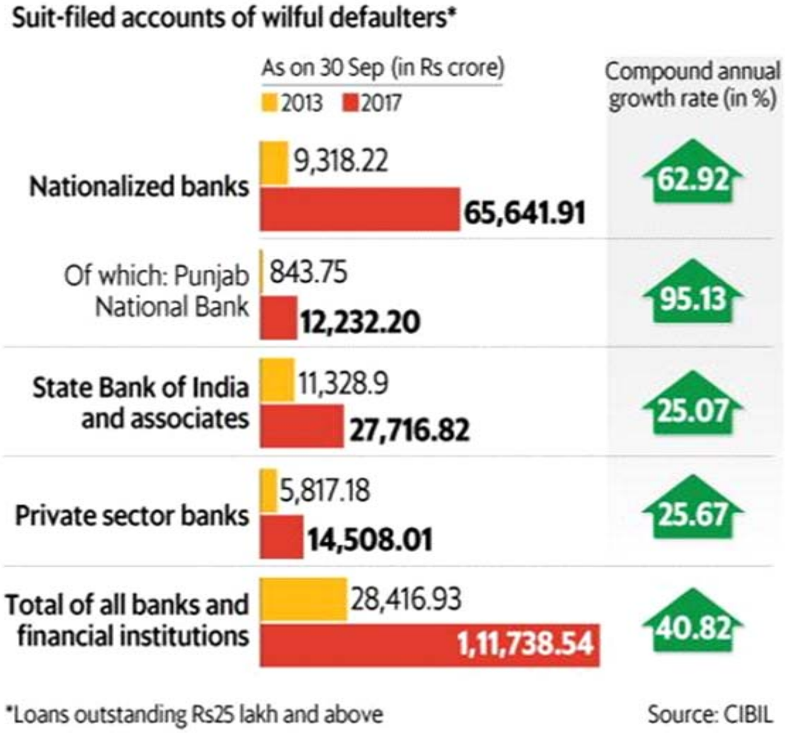
To help overcome some of these challenges, the banking regulator of India, the RBI, introduced guidelines for credit risks on large exposures of banks and financial institutions. Subsequently, in 2014, a collaborative system called the Central Repository of Information on Large Credits (CRILC) was built to help banks and financial institutions evaluate their NPAs and share information with other institutions as alerts.

Infographics can be used in the class



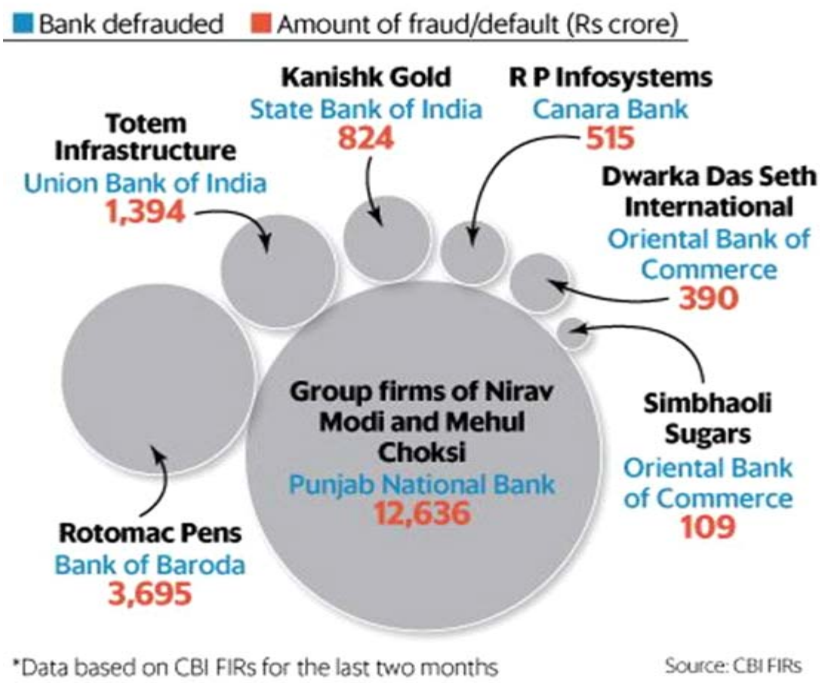
CARNIVAL OF FRAUDS

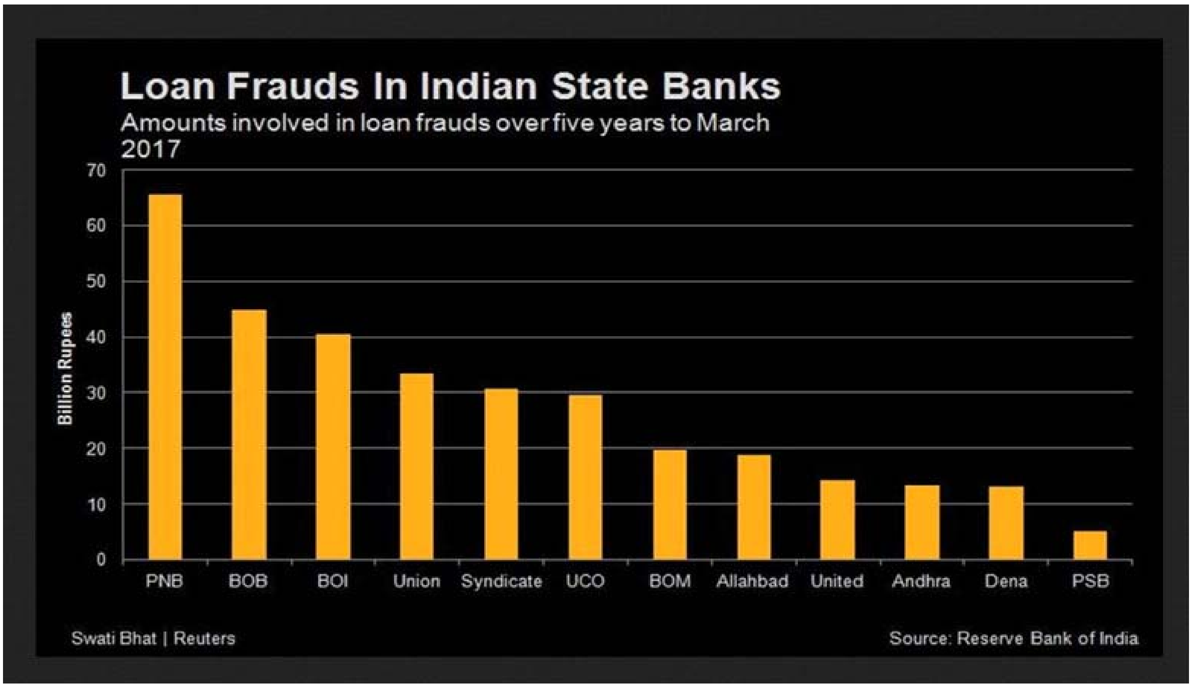
Nationalized banks have led the way in frauds, with PNB an outstanding performer.



LOAN FRAUD CASES PILE UP

The number of loan fraud cases has been piling up after the RBI directed banks to file complaints against erring companies.





Credits, References and Suggestive Reading

https://www.cersai.org.in

https://rbi.org.in

https://www.cibil.com

www.mca.gov.in/mcafoportal/login.do

www.thehindubusinessline.com/

https://economictimes.indiatimes.com

https://www.icai.org/

cbi.gov.in/

Data Breach and Cyber-Attacks: The Case of Bankcorp

Ms Aiswarya Subramanian

An account of how hackers took over the servers of one of the oldest financial institutions in the world, Bankcorp, illustrates how even the big and mighty banks are also vulnerable to vital security issues. Despite the bank investing heavily in cyber security, millions of its customers woke up to the chilling news that their names, addresses, contact details, phone numbers and email addresses had been compromised. How did the bank respond during the time of crisis? What could the bank have done differently to avert the crisis? What are the different cyber-attack modes and how have banks prepared themselves to brace against the hackers?

Keywords : Cyber Security, Data Breach, Cyber Attack Management, Banking

Bankcorp

Bankcorp is a multinational investment bank and financial services company, headquartered in New York and holds the recognition of being the world's most valuable bank by market capitalisation. It held total assets amounting to US $ 1.8 trillion and was considered as a Universal Bank. The bank functions included Investment banking, Wealth Management, Asset management and Treasury. The Bankcorp brand was unanimous with the maximum credit card usage across America and traded in NYSE, S&P 100 and S&P 500. The bank had begun its operations in 1968 and has always been in the forefront of innovative banking technologies.

a. Bankcorp and Technology

Bankcorp had set aside a technology budget of close to US $ 12 billion in 2016 and brought about a spectrum of new and fresh banking technology changes aimed at improved customer experiences. It had the first mover advantage when it introduced a mobile app called Bankcorp Seamless which was a huge success. It had efficiently analysed the market and discovered that its customers are willing to embrace positive changes that will lead to more convenience and banking on the go. They were also the first ones to adopt Touch ID for customers with Apple devices.

While focusing heavily on tech innovations, the bank has always been wary of the cyber security threats that can attack their systems at any point in time. In its Annual Report for 2016, they had clearly laid out forward looking statements regarding cyber security threats in the financial sector such as Targeted attacks, Ransomware, Mobile malware, botnets, hacking, phishing, spamming, Distributed Denial of Service (DDoS) etc. and the fact that even Bankcorp is not fool proof. The report indicated that the bank plans to spend significant amount on cyber security as its aim was to maintain the security of its operating systems and to protect against any plausible cyber-attacks by unauthorised parties.

Ms Aiswarya Subramanian (Aiswarya.subramanian125@gmail.com) Assistant General Manager, Reserve Bank of India, Hyderabad.

b. Operational risk in cyber-security

Banks are fraught with risks, one way or the other. Operational Risk figures high in the list of risks as different banks have different business models, though the essence of banking is still the same. They may not incorporate the recovery mechanisms, quick response and resilience to cyber threats in their overall risk management template, unless actually faced with one. Hence the vulnerability of the banks, its employees, customers, corporate clients etc. to cyber-attacks remain at an all-time high. It should be kept in mind that it is not just the banks that have sophisticated technologies in place, the sources that attack in the cyber world are equally sophisticated, if not more. Each new day brings a new challenge as security incidents continue to rise with more and more hackers in the market space. In such a precarious environment, it was only sensible of Bankcorp to realize that budget constraint can never be an excuse when it comes to cyber security.

Cyber-attack on Bankcorp

a. Signing the cyber-security deal

Mr Richard Adams, the Chief Financial Officer, of Bankcorp, had signed a very important deal with the top level cyber security vendors in the global market, just two weeks back. The recent news of Japanese and South Korean banks falling prey to phishing attacks was discussed fervently in the Board Rooms and was called out as a possible risk for Bankcorp as well. Having signed a half billion-dollar deal, that too on cyber security, an area hitherto ignored in the financial sector, made him feel safe and sound. The number was almost twice of the previous year. The financial giant had never faced a single security attack in the past, nor have they compromised on any Information Technology systems. So far, he has had a great run in the bank and the recent appointment of his good friend and colleague, Mr Adam Fraser, as Chief Risk Officer only added to his comfort. In fact, it was Mr Fraser, who had recommended this deal, thereby assuring the stakeholders and millions of its customers alike, that the bank was in safe hands and can "never" be under any sort of cyber threats.

b. The day of discovery of the attack

It was a beautiful June morning in Davos, Switzerland and Mr Adams and Mr Fraser were actively participating in a Banking Technology conference. The discussions on Digital Banking and electronic trading was suddenly paused with no less than a commotion as news broke in the Bankcorp camp that there has been a cyber-attack on Bankcorp. The bank's security team given a message to Mr Fraser that serious intrusions have been discovered in their information system and his presence was essential at the Headquarters. Frazzled and completely taken aback by the magnitude of what they have heard, the two men rushed back in fears of whether there has been a targeted phishing attack at their back-end data systems, all the while assuring the rest of the conference that it was just an internal emergency. The bankers were also cautious not to raise an alarm among the press and the public alike, as they wanted to ascertain the length and breadth of the damage before intimating their stakeholders.

c. Crisis management

A board meeting was immediately convened involving the top officials and the cyber security team. Crisis Management has always been at the helm of Bankcorp and it was recognized by the board members that they were now under an increased pressure to keep up the reputation of the bank and the customer trust. Stressing on the business model which was built in large part on trust and customer relationships, a special committee to overlook the crisis was established to find out the response mechanisms. It was decided by the board that the CEO and the spokesperson of the bank would not speak out publicly regarding the cyber-attack until the facts and figures have been well established. The committee was also allowed three days' time to manage the content and timing of disclosures. It was also understood that in case of any violation of customer data, the bank will issue personal apologies and take responsibility, thereby performing the cardinal job of upholding customer trust.

d. Techniques employed by hackers

The cyber security team headed by Ms Anne Williams, presented the initial figures and statistics. It was revealed that the bank had sustained a cyber-attack that has compromised the information pertaining to close to 80 million households and 5 million small enterprises. It was not figured out whether the hackers had stolen the usernames, passwords and other such more sensitive information. On an initial search, the names, addresses, contact details, phone numbers, and email addresses were only estimated to be compromised. It was also not understood what the hackers will do with the stolen data such as names and addresses. One of the junior security risk associates brought to the table the fresh information that it has now been ascertained that bank account numbers, user ids, passwords, debit and credit card numbers, ATM pins, Social Security Numbers, etc have been fully firewalled and protected. The hackers have not been able to breach this particular security blanket and it was also interesting to note that the attempt was also not made.

Ms Williams pointed out that despite crucial information not being stolen, the matter of concern was that mostly those customers who availed the facilities of online and mobile banking, were exposed to maximum risk. Bankcorp Seamless, Bankcorp.org and Corpmobile are the worst affected parties. She put forth an alarming observation that the attack seemed to have begun as early as May 16, 2017 and had been continuing ever since but had escaped the notice of every firewall had been put in place. The security servers had failed to detect any penetration till date i.e. June 05, 2017. The people and businesses who have been hit, have all been victims of different forms of phishing. Phishing is any fraudulent attempt aimed at obtaining sensitive information such as passwords, card details etc through email spoofing. This is mostly carried out purely for malicious reasons.

Bankcorp had been subjected to phishing attacks in the past too, but there was no consequential evidence of any data breach in those instances. In the present case, fraudsters had impersonated as legitimate Bankcorp website and sent out emails instructing millions of people that their accounts are at risk of theft and in order to avert that, they should click on links which will verify them as bonafide users. The URL of Bankcorp's official email id had been so deceptively imitated that close to 57 million accounts were compromised in this manner.

The hackers had employed the technique of 'Pharming' also effectively. The Domain Name System (DNS) cache poisoning attack as it is otherwise referred to, targeted the DNS server and changed the IP address of Bankcorp internet banking website. The attacker thus fraudulently redirected anyone trying to access internet banking to a malicious website from where all data entered in the keyboard was captured. The targeted victims were the ones who entered their login credentials using http instead of the https-protected website.

Though online banking sites give customers the option of using a virtual keyboard, in order to escape from Keylogger, which is a software that can record the sequences and strokes of our keyboard and transfer it as a log file and store it in the machine, very few people actually make use of the facility. It is suspected that keyboard capturing has indeed taken place in this case. Interestingly, the method of Eavesdropping which is a form of passive attack on systems, generally used by government agencies, was also employed in this cyber-attack. Though the motive seems to be not so fraudulent, systems were harmed to the point in which information had been stolen without being identified by the people. They had targeted emails, SMS, phone calls, Google and Bing logs, etc.

e. Drawing a parallel

Ms Williams culled out the worst cyber-attacks that corporates have faced in the past along with how the markets reacted upon hearing the news of the data breaches so as to draw a parallel to what could be the probable stock market dip when the news is announced to the public and the press.

It was concluded that multinational corporates like Sony, Ebay, Target and Home Depot have also suffered huge losses and stock market dips following cyber-attacks and data breaches. Even more than the monetary losses that hit the company, it is more the reputational risk. Also, though it was not uncommon for companies of this size to experience cyber-attacks frequently, the magnitude of this particular attack seemed to point towards other ulterior motives. As no financial data was compromised, it was also not necessary for the customers to subscribe to an identity theft monitoring service, which if required Bancorp can extend to its customers for free as well, as a goodwill measure.

The board meeting was dispersed with the general consensus that though measures had been put in place in the bank to resist such an attack, it can be a learning curve for everyone concerned that their defences need to be much stronger. They also set out the agenda that the board will meet within the next three days to finalise on the actual impact of the breach as well as to discuss the future course of action.

Strategies and Way Forward

When the board met next on June 08, with Mr Adams, the CFO, it was with an agenda clearly established and risks to the bank were prioritized and categorised accordingly. Many verticals of the bank had to come together to collaborate and collate the pertinent information. The Risk Management Department, Fraud Monitoring Division and Cyber Security cell of the bank took turns in addressing and apprising the senior officials about the possible strategies and way forward. Decisions were taken based on data sets provided by these verticals.

a. Bankcorp had acted immediately to stop the intrusion as soon as they had discovered the data theft. The company quickly engaged an independent cybersecurity firm that has been conducting a comprehensive forensic review to determine the scope of the intrusion. The bank also reported the criminal access to law enforcement authorities. Although the preliminary investigation of the bank is substantially complete, the case is declared to be ongoing and is expected to be completed in the coming weeks.

b. Federal authorities were first alerted on June 05, 2017, the day on which the breach had come to light. It had been treated as highly confidential considering the impact the news could have in the market. Four suspects had been indicted by the federal authorities, two in NewYork, one in Georgia and the fourth in Texas. The charges on them varied from hacking multiple financial service institutions and obtaining access to more than 85 million customer accounts by identity theft, money laundering and unauthorised access to private computers. The names of the charged suspects including the copies of their previous case files were circulated among the members. It was a news to everyone that Bankcorp was not just the target, but even Dow Jones and Wells Fargo were among the companies whose cyber blanket had been breached.

c. The scope of the breach was revealed in a filing with the Securities and Exchange Commission two days after the attack came to light. A new report also suggested that Russian hackers might be behind the case as nine other financial institutions across the world were hit during the same period and majority of the hacking locations pointed to regions in and around Russia. All of the targeted companies had the identity information such as addresses, and phone numbers of their customers stolen, but not any sensitive information or financial information such as passwords. The federal authorities were concerned if the attacks were more about politics than profit.

d. The timing of announcement of this news to the public and press could be at the earliest, i.e. June 09, as already three days had elapsed since the discovery of the identity theft.

e. The Chairman and CEO, along with the CFO and his team could give out a clear message apologising to consumers and business customers alike thereby establishing that the bank is really concerned and equally frustrated with the data breach. The CEO could also give out a message which echoes the sentiment, that while the bank takes pride in being a leader in the financial sector, they are, at the same time, not fool proof. The bank is also conducting a thorough revision of its security operations. They are also intent on protecting and putting their consumers first, and hence will extend complimentary support services for all portfolios of all U.S customers, regardless of whether they have been impacted or not.

f. Bankcorp has been proactive in its establishment of a dedicated website, www.bankcorpsecurity.com , for its retail customers and small businesses to determine whether they have been impacted. The website provides information on important steps the customers should take to protect their information. They can also sign up for identity theft protection in the future. A dedicated call center has also been set up with a toll-free number to assist the consumers which will be open every day including weekends. In addition to all this, Bankcorp will also send emails and text messages to the affected parties, as soon as the announcement is made to the public.

g. Bankcorp has always sent push notifications to all of its customers at regular intervals stating that Bankcorp never asks for any personal information in an email or text message. All its customers have already been educated to terminate any such conversation and instead call the bank to let them be aware of the contact number details. This exercise will be repeated frequently. People will also be made aware of the importance of password change, both while using debit and credit cards and internet banking and also to use virtual keyboards as much as possible to prevent any phishing attack. Customers are made more vigilant of all the ways their sensitive information can be stolen and the ways in which these can be avoided.

h. The data breach has cost the bank approximately an average of USD 154 per record and thus for 85 million records, Bankcorp might lose a staggering USD 13 billion, including the loss of any potential business.

Disclosures

a. Mandatory disclosures

As discussed in the board meeting the previous day, the Chairman and CEO along with their team announced the news of data breach to the Press and the public, while issuing a formal apology at the same time. He also noted that though the bank had continually fortified its defences, the battle against hackers will be a never ending one with little recourse available. He said in his statement that companies of their size unfortunately experience cyber threats every day and that they have multiple layers of security to counter any such threats. The cyber-attack was briefly acknowledged in the Bankcorp website. FBI and other federal prosecutors in New York were treating the attack as a criminal investigation. The bank declined to comment any more on any other media. Since then, the Bankcorp incident has been compared to the NASDAQ hack as cyber espionage seemed to be the motivation for the attack rather than any profit motive. Similarly, in the NASDAQ attack, systems were surveyed but no visible signs of damage or theft were detected. It must have been understood by the hackers that any attack on any one financial institution in Wall Street will have a domino effect in the US markets.

b. Lessons learnt from Bankcorp

The breach at Bankcorp was flagged as a wakeup call for every organization to consider security as a top priority. A report by Bloomberg, much later after the attack, said that "attackers appear to have exploited multiple zero-day vulnerabilities in their attack, and to have routed stolen data through multiple countries, including Brazil, before finally routing much of it to a large city in Russia." According to a report in New York Times, the massive data breach could have been averted if only the bank had incorporated two-factor authentication in its network servers. This could even explain why the other financial institutions which were targeted at the same were not affected at such a large scale.

c. Solutions adopted

This oversight by the security team in Bankcorp has become the focus of its internal review which will identify if there are any more loopholes in its vast network. A Business Control Group has been set up consisting of technology and cybersecurity experts to prevent hackers from breaching data in the future. The group convenes meetings once every two weeks. The bank is committed to be proactive in identifying future threats and to ensure that the culture of the organisation changes in a way that every employee is on the lookout for potential risks. This calls for bank wide training and innovative corporate governance.

The bank has also begun using "cyber ranges", which are virtual environments where real cyber-attacks are simulated on actual IT system replicas. The goal of this practice is to keep their cyber teams ready and prepared to defend a cyberattack at any point of time. When the attack is simulated in a protected environment, it’s no longer a theoretical one and hence, the level of readiness to face an actual challenge will be higher and might just be the next best thing for dealing with asymmetric cyberattacks. They can respond actively to malware, hone their response skills, improve controls in a way that does not impact production systems. This technique has been widely accepted by other large banks as well, though it is yet to percolate to the small and medium sized banks as they cannot afford it in most cases. The expense involved in having a sophisticated red team, which is an independent group that can challenge its organisation for improved effectiveness, is on the higher side. It has been suggested by industry experts that the financial industry should create shared cyber ranges which can perhaps be hosted by Financial Services Information Sharing and Analysis Center (FSSCC), the industry’s cyberthreat information-sharing hub and used by many.

d. Wells Fargo approach

Wells Fargo, in a similar case, was affected by a denial-of-service cyber-attack in 2013, but customer account balances and other information were not affected. The Wells Fargo website was faced with an unusually high volume of website traffic which is characteristic of denial-of-service attack. Such kind of an attack can only temporarily affect a site’s usability and customers funds and personal information won't be compromised. Wells Fargo was one of the first major banks to build cyber ranges in geographically diverse groups of cyber threat centres. They tried to replicate an entire IT infrastructure despite it being a costly affair.

Cybersecurity Challenges Facing Financial Service Institutions

Drawing a definite conclusion from the Bankcorp case on how cyber-attacks can be prevented is a not so easy task, however, we can put in a nutshell, the cyber security challenges facing financial service institutions and how best we can be proactive in such situations.

a. Cyber threats are ever-changing phenomena and they are omnipresent. Many institutions might not be able to put in place checks and balances sufficiently needed to avert cyber-attacks, but they can focus on one issue at a time and build on from there. Hackers are constantly evolving their technologies, they are well-funded, highly skilled and highly motivated to stay ahead in the game. The threat mitigation tools available to the organisations are not so many.

b. Many companies outsource their cyber security to third party vendors and cloud vendors. To reduce risk while outsourcing, its better if the companies can ensure where the data is stored, who is given access, how does the third-party contractor protect data during transfer and storage and whether cloud storage affects the company's ability to keep sensitive information safe. Companies should protect their data with cloud audits too so that they can exert enough control over the safety of vital information.

c. In a study conducted about cyber-attacks, an astonishing three quarters of the attacks were launched by company insiders, mostly disgruntled tellers, who want to attack the bottom-line of the business thereby doing harm to the company. The other one quarter was conducted by human/clerical error, where malicious files were downloaded in the system without malafide intentions. The best way forward in such cases will be to have in place a robust firewall and to monitor defences 24x7.

d. What could be a possible source of reputational nightmare for any firm is Distributed Denial-of-Service attacks (DDoS). All finance companies should take DDoS threats seriously, as the panic than can be created among customers if they are unable to access their online accounts and not being able to see their balance of accounts will be too much. More and more attacks are launched via the Internet of Things (IoT) which have prompted legislations to be mandated that advising device manufacturers to meet certain minimum cyber security requirements that will reduce the immense risk to IoT devices.

The Big-picture Approach

The banking industry is growing at an unprecedented rate and unmanned aerial systems, Internet of Things, Near Field Communication, cloud-based platforms, robotic process automation and cognitive technologies are some of the technological advancements that banks will be considering in the future. Banks have begun to recognize biometrics and tokenization as additional controls for security of sensitive data. Blockchain could reduce banks infrastructure costs by US$ 15-20 billion per annum by 2022. Banks and financial institutions will continue to leverage digital technologies to improve user experience, and for a seamless transition to take place, a cyber security policy should be kept in place which is distinct from the broader IT/ IS security policy of the bank.

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Teaching Note

Synopsis

An account of how hackers took over the servers of one of the oldest financial institutions in the world, Bankcorp, illustrates how even the big and mighty banks are also vulnerable to vital security issues. Given that the bank had a history dating over 200 years, millions of customers and many of the world's most prominent corporate clients readily believed in the security of this global financial services firm, which ultimately will send them into a rude awakening. Despite the bank investing heavily in cyber security, 85 million customers woke up to the chilling news that their names, addresses, contact details, phone numbers and email addresses have been compromised. How did the bank respond during the time of crisis? What could the bank have done differently to avert the crisis? What are the different cyber-attack modes and how have banks prepared themselves to brace against the hackers?

Learning objectives

After reading the case, students must be able to deduce correctly the three important focus areas of the case, which are: a) Cyber security methods 2) Cyber-attack modes and 3) Crisis management techniques. They must have a clear idea about the history of the case as well as how the top management at Bankcorp brainstormed the efficient management of this crisis. They should be aware of the different cyber-attack techniques employed by the hackers. They must analyse and understand the lessons learnt and solutions adopted by the bank and apply them to other similar cases. If asked to draw out a strategy and way forward, they must be able to connect and correlate between the cyber-security challenges facing financial service institutions and the big-picture approach.

Teaching plan

Before handing over copies of this case to the students, it is highly necessary to make them understand the basics of cyber security. They need to be taught about how multinational organizations invest in cyber security and the importance of technological innovations. They can be taught about the different methods of hacking including ethical hacking to impress upon them the dangers lurking in the cyber world. Once the students are clear on the abovementioned topics, the case may be distributed to them. The students may be divided into teams of three or four. They may be given an assignment to read the case before hand and to prepare answers for the following questions arising from the case, and the solutions may be finalised after a group discussion.

Discussion questions

a. Is a half-billion dollar deal necessary for cyber security? Should companies really invest that much in this field?

b. Despite investing heavily in the fields of tech innovations and cyber security, Bankcorp was hacked. Where did the bank fall short?

c. Was the crisis managed by the top management effectively? If not, what could they have done differently?

d. Discuss the strategies adopted by Bankcorp following the data breach and each of their significance.

e. Discuss the various cyber security challenges in the context of companies in different verticals.

Analysis

It may be considered that due to potential conflict of interests, the name of the bank, Bankcorp, has been made hypothetical. This case is an actual incident that happened in JP Morgan Chase in 2014 and which was famously referred to as the "2014 JPMC data breach". Though the facts and figures closely mimic the actual JPMC data breach, the case has been given a different storyline for the interest of the students.

A guide to Discussion Answers

a. With technological innovation happening at a rapid pace, more and more companies are investing on high tech capabilities and hence, cyber security. Hackers, being highly paid and therefore highly motivated, are always in the lookout for any strategic loopholes in a system. Companies should first analyse where the risk lies, invest in cyber ranges, do simulations, then invest in cyber security mechanisms as this approach will help them invest in the right areas instead of fully outsourcing the cyber security vertical to a third-party vendor.

b. The bank had done right in investing in cyber security, but what the bank failed to do is test runs and simulations, to critically analyse the source of cyber threats. As in answer no. (a), analysis plays a critical role.

c. This is a purely subjective question, as, crisis management theories vary widely across different sectors. Bankcorp top management did respond effectively to the crisis, though they failed in the discovery of the threat immediately. It took a while for their systems and manpower to realise that their systems are under attack. However, on discovery of the attack, the crisis management was smooth as they had a well-set risk management strategy in place.

d. Refer to pages 14 and 15 of the case

e. Help students pick up companies in varied verticals and to make short presentations on cyber-security challenges faced in each of them. This exercise helps them gain an in-depth understanding of the subject.

Suggested Reading

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Digital Tools and Recovery

Shri Vineet Kumar Jain

Non-performing assets (NPAs) are a major concern for any bank. Maintaining the asset quality and recovering overdue is a great challenge. The retail loan segment is the largest contributor in terms of the number of NPAs. Some of the retail loan borrowers default due to genuine reasons. But, many of them do so wilfully. Orthodox methods have failed to recover overdue from these defaulters. This case helps us to understand that retail loans are recoverable; what is required is a better understanding of human psychology. It is a connected world and life without social media is a distant dream. We find that any KYC-compliant borrower cannot be untraceable. Through this case, we can understand the importance of various digital tools and platforms in finding pressure points of individual borrowers. It also shows that asset quality can be improved significantly by using these tools in our credit delivery mechanism.

Keywords: NPA Management, Recovery, Digital Tools, Asset Quality Management

Introduction

It was the cold month of January but all the executives present in the boardroom of ABC Bank Ltd. were sweating as if it was the peak summer of June. Mr Narendra Damodaran, MD and CEO of ABC Bank Ltd., was analysing the performance of the third quarter, which ended on December 31. He was very disappointed as the asset quality was deteriorating and the profitability of the organisation was at an all-time low. He made his point very clear: "We are not an average bank. Neither do we want our people to be average. But our results are below average. We have to accept that a large portion of our loan portfolio is not yielding any return for us. On the other hand, the regulator has made it clear that we have to clean up our balance-sheet. So, the last quarter of this financial year is going to be very challenging. We don't want to end this financial year in the red. The single point agenda for this quarter is recovery."

ABC Bank Ltd.

ABC Bank Ltd. had a 5,000+ branches' network with 40 per cent branches in rural, 20 per cent in semi-urban, 20 per cent in metro and 20 per cent in urban areas. It also had 9,000+ ATMs and self-servicing channels. It was a respectable name in the Indian banking industry with more than 4.89 per cent market share in the total business. It also had a significant global presence across 123 offices spanning 28 countries. With a customer base of approximately 75 million, it catered to the needs of all segments of the society. The segment-wise deployment of domestic credit is shown in Annexure I (a) and segment-wise deployment of retail credit is given in Annexure I (b). Movement of restructured assets, gross NPAs and net NPAs is presented in Annexure II (a). Segment-wise distribution of NPAs in the retail segment is stated in Annexure II (b). Quarter-wise movement of business figures is shown in Annexure III (a). Comparative share price movement of ABC Bank, Bank Nifty and NIFTY is furnished in Annexure III (b).

Shri Vineet Kumar Jain (vineet.jain104@gmail.com) Chief Manager, Bank of Baroda, Delhi.

Recovery Department

Mr Narendra Damodaran assigned the Herculean task of recovery to Mr Vinay Garg who had earlier worked in the Forex and Operations Department. He had also served as branch head of various large branches for 12 years. This was the first that he is working in the Recovery Department. He was given the target of reducing NPAs by 20 per cent (terminal figure of NPAs as well as number of NPA accounts). Mr Garg decided to review the structure of the department immediately. Presently the Recovery Department served as a controlling office and its major task is collecting information related to NPA accounts The organisational structure is shown in Annexure IV (a). Mr Garg added one more team to this structure, which is named, Special Task Force (STF) – see Annexure IV (b). He also discussed the methods available for recovery (The existing methods of recovery are discussed in Annexure V). He asked for data on a number of accounts and amount in different categories of NPAs. He is surprised to see that out of 2,16,065 NPA accounts, 95.42 per cent of the accounts i.e. 2,06,170 accounts are below Rs. 25 lakhs. But, the amount outstanding in these accounts is only 6.72 per cent of the total outstanding in all NPAs as per Annexure V.

Strategy

Mr Garg knew that everyone had been targeting large NPAs and 20 per cent reduction in terminal figure of NPAs was achievable, but what about 20 per cent reduction in the number of NPA accounts? He decided to prepare a strategy for retail accounts. First of all, Mr Garg started to search for FDRs/alternate accounts of these NPAs so that the 'right to set off' could be exercised. He asked Neha, a member of the STF, to generate a report of all accounts of NPA borrowers. He was surprised to know that Rs 60 crore was lying in different accounts of these NPAs with the bank. He immediately issued an advisory to use the 'right to set off' and recover that amount. Recovering Rs. 60 crore was a big success. Mr Damodaran called and congratulated Mr Garg, who took up his second strategy.

- ❑ A Recovery Task Force was constituted at each administrative office and every member of this team was allotted a certain number of accounts. Their duty was to make physical contact with these borrowers and to persuade them for recovery.
- ❑ Daily monitoring was enabled and the task force to report its progress on a daily basis to the nodal officer at the administrative office level.
- ❑ It was advised that SARFAESI notice must be served in all the eligible cases.
- ❑ Settlements through LokAdalat were also promoted.

The results were encouraging and loan recovery began. However, the speed of recovery was not as expected. Mr Garg was not able to understand the reasons behind this slow rate of recovery.

The Jigsaw Puzzle

Mr Garg knew that reducing the number of NPA accounts by 20 per cent was a very tough task. But at the current speed of recovery, even a 5 per cent reduction in the number of NPA accounts was impossible. He immediately asked his team to contact all the administrative offices in the country and collect the most common reasons for retail accounts turning into NPAs and problems faced while recovering overdue. Segment-wise details for housing loan accounts turning into NPAs – Annexure VII (a), car loan accounts turning into NPAs – Annexure VII (b), and education loan accounts turning into NPAs – Annexure VII (c) were obtained. The main findings of this exercise were as below:

- Branches had not done the KYC exercise properly. Many accounts turned into NPAs as all the submitted KYC documents were fabricated or impersonation was done. Further, fudged financial statements, inflated security valuation reports, defective search reports for title deeds of mortgaged property were also seen in various cases. This was especially observed in housing loans, loans against property and car loans.
- The next problem was that borrowers become untraceable after taking loans. Even detective agencies gave negative reports and the whereabouts of the borrowers were not available. This was seen in education loans, personal loans and car loans.
- It was also seen that many borrowers were wilful defaulters. They had the capacity to repay but were not willing to repay the full amount. To recover this amount from these borrowers, it was a big challenge as they knew that banks could not recover the amount easily in absence of any security. This was seen in education loans, personal loans and car loans.

Mr Garg started brainstorming on the KYC process with his team. Finally, they were able to find various sources to ascertain genuineness of financials/documents. Details of the same were circulated to all the branches – Annexure VIII. However, he was not able to find the answer to two problems:

1. How to trace the untraceable borrowers?
2. How to make wilful defaulters to pay their dues?

Digital Tool: A Game-Changer Strategy

The next day was a leisurely Sunday morning and Mr Garg was reading the newspaper and sipping his morning tea. His son, Mayank, was working on his laptop. He asked Mayank, "What are you doing?" "I am trying to search for one of my old friends on Face Book. I will be free in 10 minutes," Mayank replied. Mr Garg, who was still thinking about the untraceable borrowers, grew curious and asked Mayank, "Is it actually possible to find someone in 10 minutes?" He was all the more surprised when Mayank managed to trace his friend within five minutes. "It is a connected world and life without social media is a distant dream. Half of the world is using various social websites to connect with each other. Today, you can search for anyone on these platforms. Further, various details given on social websites like Facebook or LinkedIn etc. can be crosschecked e.g. name of the school, year of passing, etc. and if they match then there is a very high probability that the person detailed in the social website is the person we are looking for,"Mayank elaborated. Mr Garg felt as if he had found the 'missing link'.

Strategy - Trace the Untraceable

Next day when Mr Garg reached his office, he asked Neha to start working on the file which belonged to two sisters named, Avantika Jain and Renuka Jain. Avantika had been sanctioned an education loan of Rs 2 lakhs for pursuing B.Tech from MDU, Rohtak and Renuka had been sanctioned an education loan of Rs 1.50 lakhs each for pursuing MBA from Amity University, Noida. As per the last inspection report, the parents/sisters were not traceable (details as per Annexure IX). Vinay instructed Neha to write down the unique information related to the borrower from the file. The unique information comprised:

- Date of birth
- Name

- School name
- Passing year.

Neha informed him that she could generate the PAN number by using the person's date of birth and name. She did so from the Income Tax Office website and generated a CIBIL report using these PAN numbers. However, no other useful information was available in the CIBIL record. Now Mr Garg asked Neha to find them using the social media. Neha did the same and was able to trace both the sisters. Avantika was pursuing MS from Wharton School, London. Renuka was working as a placement coordinator with AS Engineering College, Noida. Neha immediately searched for the college contact number and e-mail address through Google. She then called up the given number. Someone else picked up the phone and confirmed that Renuka was working there. The person also informed that Renuka was on leave and would be available the next Monday. Neha informed the person that she was calling from ABC Bank and the call was regarding her education loan account. Neha also informed the branch about this development.

Next day, Neha received a call from the branch that Mr Pawan Jain, father of Renuka and Avantika, had visited the branch and deposited Rs 50,000 in the education loan account of his daughters. Mr Pawan also gave an assurance that he would deposit Rs 50,000 on a quarterly basis in both the education loan accounts till the final closure. Neha informed Mr Garg about this development. Mr Garg realised that once one traced the untraceable borrower, recovery was certain. He immediately asked Neha to prepare a write-up on tracing a person through the social media/CIBIL records and circulate it amongst all the branches. Detail of the process are as per Annexure X.

Strategy - Finding Pressure Points

Now, Mr Garg was left with only one question i.e. How to search for bargaining points and make wilful defaulters to pay? He asked Neha about any compromise proposals pending with the nearby branches. Neha told him that a car loan of Mr Ramesh Anand and an education loan of Mr Manas Ranjanhad been discussed by their XYZ branch. Mr Garg decided that he would negotiate the compromise amount in those two accounts. He asked Neha to collect files of those two accounts and to search for all the available information regarding those accounts from various websites. Neha did the research and came up with the following points.

- Mr Manas Ranjan availed a loan of Rs 3.40 lakhs for pursuing B. Tech. He did not pay even a single EMI. The default was not reported to CIBIL as no unique ID of the borrower was available with the branch. He was currently working with a MNC. He had also availed a car loan from some other bank. One of the posts on his Facebook wall was: "Cleared SBI PO exam. Now, preparing for interview."
- Mr Ramesh Anand was a businessman who had availed a car loan of Rs 10.23 lakhs. His car was stolen and no other security was available with the bank. He deposited only the insurance amount and was not ready to repay the remaining amount of Rs 1.43 lakhs. The default was reported to CIBIL also. Subsequently, his CIBIL score was downgraded to 630. He had a decent income and he did not avail any other loan facility with any bank. He loved travelling and last month had enjoyed a Europe trip with his family. His last post on Facebook was: "All set for my dream home. Deal finalised."

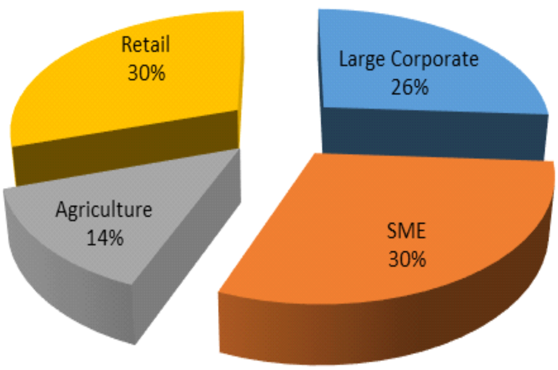
Mr Garg could not stop smiling. Mr Garg knew that he had found the pressure point for those borrowers. A meeting was scheduled between Mr Garg and Mr Manas for the very next day in the course of which Mr Manas said, "My financial condition is not good. I am searching for employment and I can't repay the loan. I know that the Government of India provides interest subsidy to education loan accounts. I request you to claim the same. Further, many of my friends have already availed waiver of 50 per cent repayment on principal amount. If you agree for the same waiver, then I can repay the remaining 50 per cent of the principal amount in 24 instalments."

Mr Garg listened to him patiently, smiled, and said, "Congratulations! You have cleared the SBI PO examination. I wish you all the best for your interview."Mr Manas was surprised. Mr Garg continued, "But do you know that there is a clause in the SBI PO selection exercise which states that one should not be a defaulter in the CIBIL record. We have not reported your name till date. But, do you want that? We also know that you are working with the MNC and your salary is sufficient to serve the EMI. Now it is upto you."Manas was completely taken aback; beads of sweat appeared on his forehead. Mr Garg, on the other hand, knew that the battle was won. Mr Manas finally agreed to deposit the overdue amount.

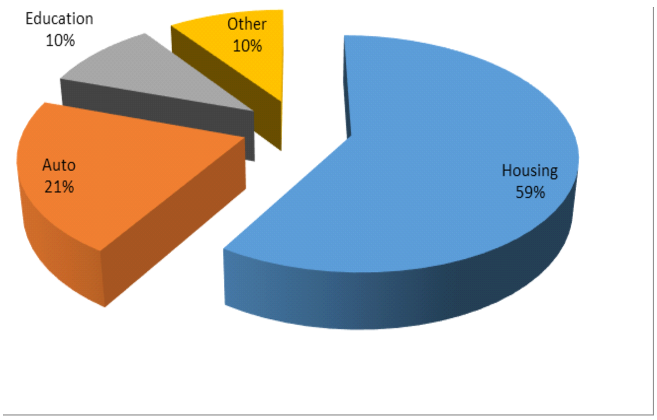
Mr Ramesh did not know anything about CIBIL. Mr Garg told him, "You will not be able to raise a loan for your house as your CIBIL score is very low. Further, even if you are able to get a loan sanctioned, you will be charged a higher rate of interest. In the coming years, you may require money for your child's education or business expansion. But no bank will help you in the future. This is a small amount and by not paying this amount you are harming yourself and your family." Mr Ramesh, on coming to know that he could even get a concession on the interest rate based on a good CIBIL score, immediately agreed to deposit the overdue amount. Mr VGarghad succeeded in his endeavour. This strategy was shared with all branches.

It was the last month of the current and financial year and the prescribed target of reducing NPAs by 20 per cent (terminal figure of NPAs as well as number of NPA accounts) was well within reach. The team was jubilant but Mr Garg was not the one to rest on his laurels. He congratulated his team and motivated them, saying, "This is just the beginning. There are several unexplored digital tools which can effectively be utilised for our purpose. Who knows, our next success may come from True Caller or matrimonial sites or LinkedIn. The basic idea is to think out of the box and act accordingly."

Annexure I (a)
ABC Bank Ltd
Segment-wise Deployment of Domestic Credit (Percentage Share)



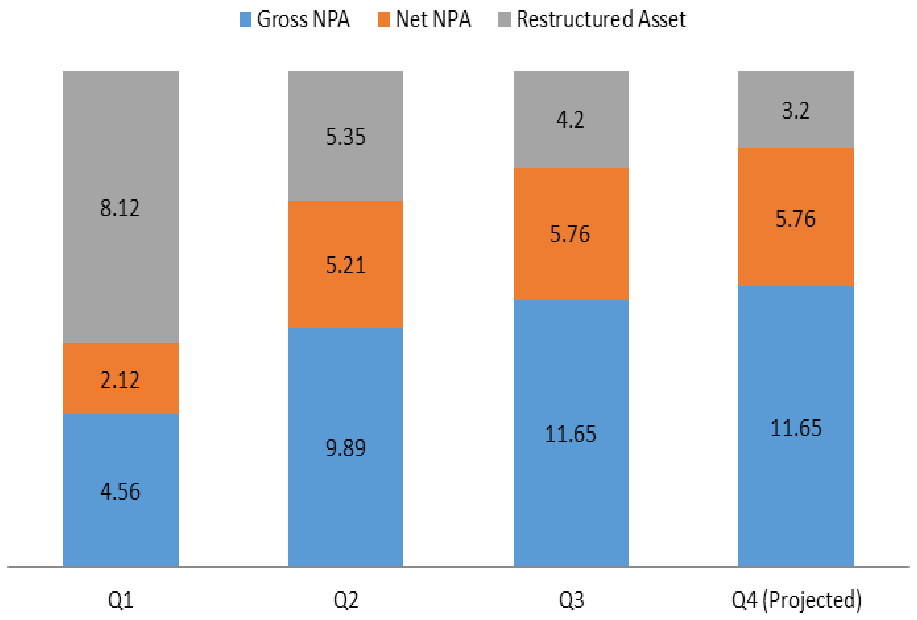
Annexure I (b)
ABC Bank Ltd
Segment-wise Deployment of Retail Credit (Percentage Share)



Annexure II (a)

ABC Bank Ltd

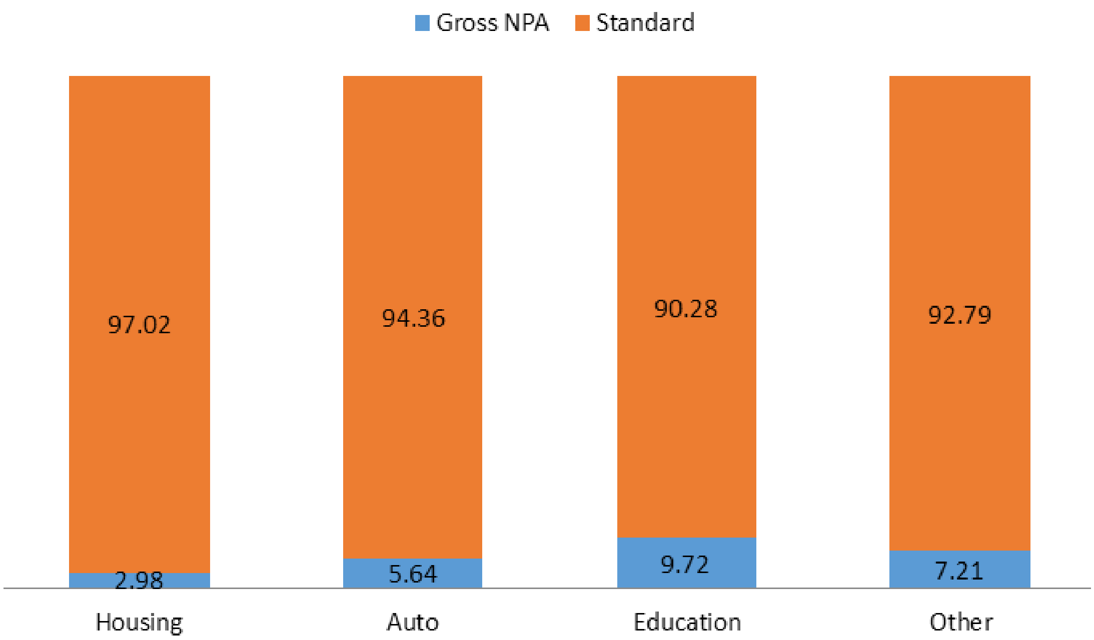
Movement of Restructured Assets, Gross NPAs and Net NPAs (Percentage of Gross Advance)



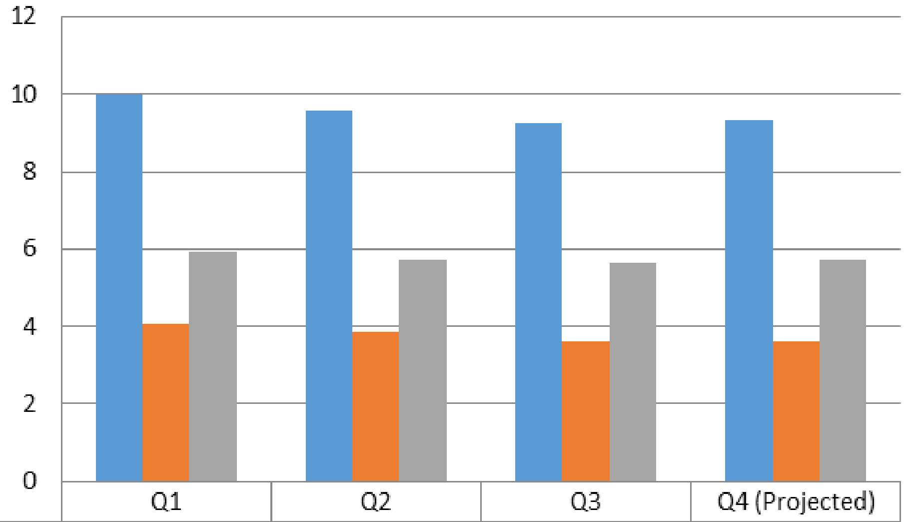
Annexure II (b)

ABC Bank Ltd

Segment-wise NPAs in Retail Loans as on Last Day of Q3 (Percentage of Segment)

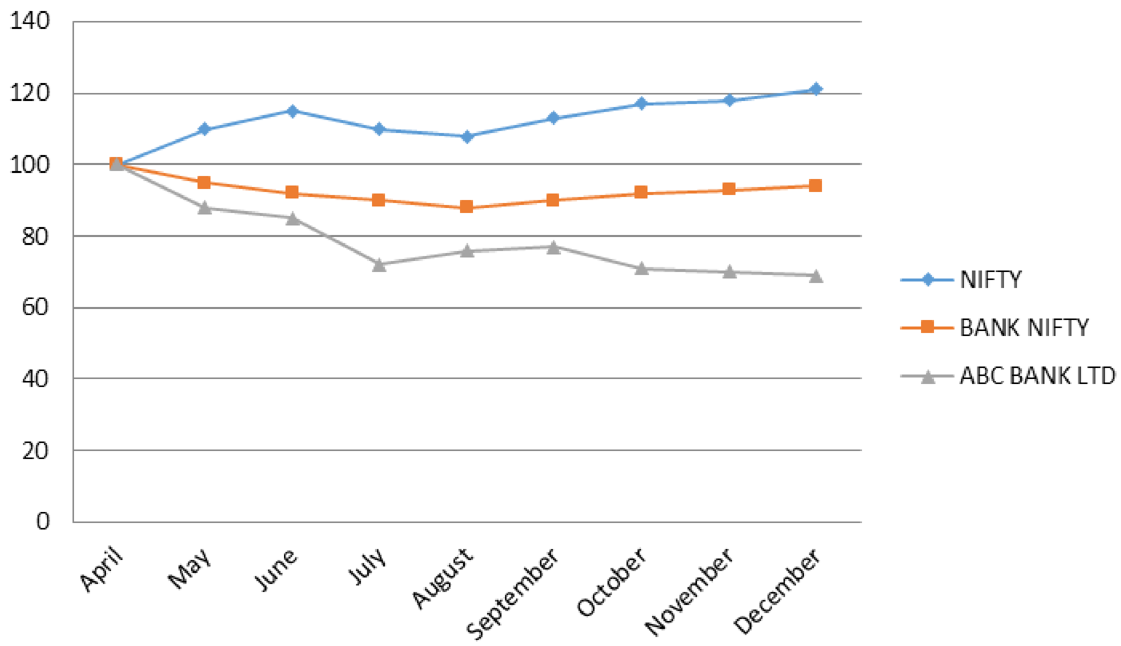


Annexure III (a)
ABC Bank Ltd
Movement of Business Figures (in Rs Lakh Crore)

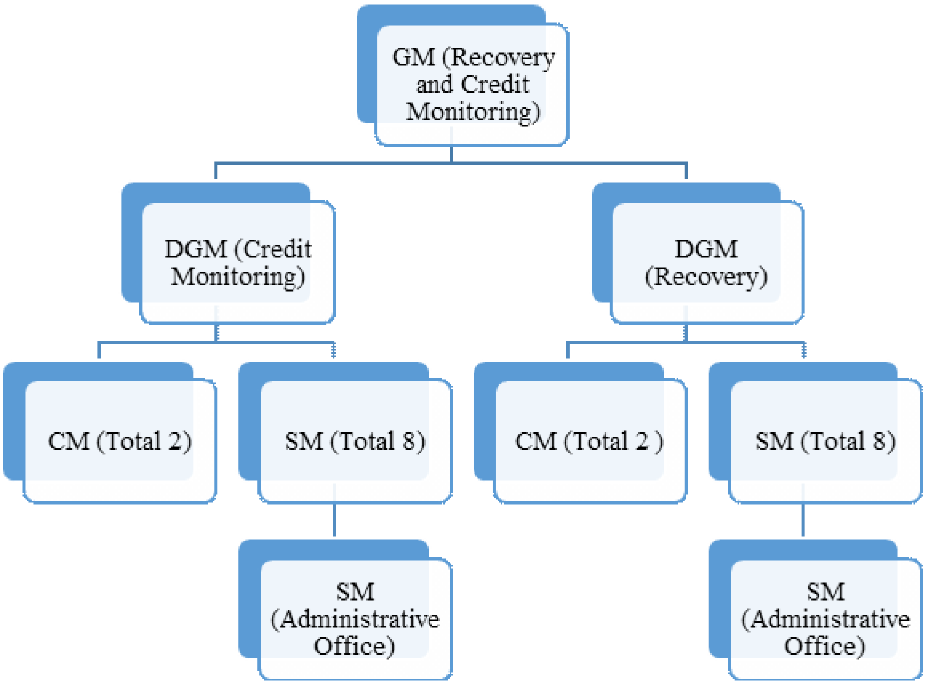


	Q1	Q2	Q3	Q4 (Projected)
Domestic Business	10.01	9.58	9.25	9.31
Domestic Credit	4.07	3.84	3.63	3.59
Deposits	5.94	5.74	5.62	5.72

Annexure III (b)
ABC Bank Ltd
Comparative Movement of Share Pice of Bank, Bank Nifty and Nifty

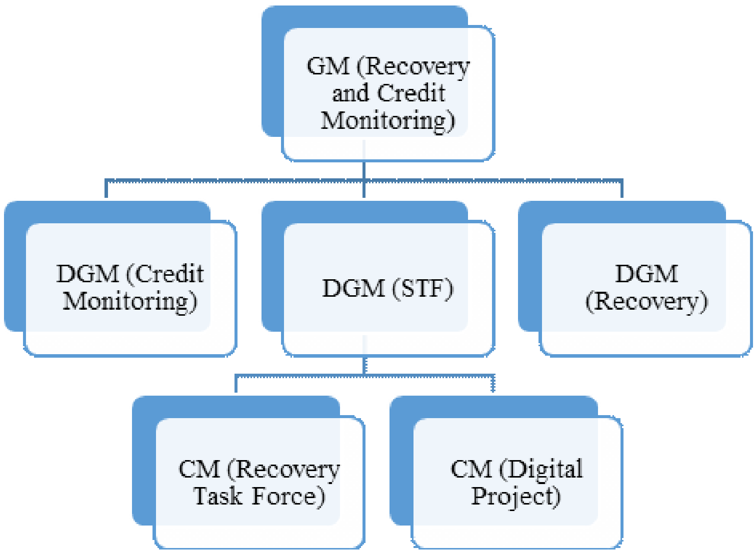


Annexure IV (a)
Departmental Structure of Recovery Department



GM = General Manager; DGM = Deputy General Manager; CM = Chief Manager; SM = Senior Manager

Annexure IV (b)
STF (Special Task Force)



*Each CM was assisted by four SMs. Neha was Senior Manager and reported to CM (Digital Project)

Annexure V

Methods for Recovery

Recovery measures are classified into two categories:

Non-Legal Measures

- *Recovery Agents:* Enforcement agencies and recovery agents are used for taking physical possession of assets, guarding of the secured assets, sale and post-sale actions under the SARFAESI Act.
- *Compromise Settlement:* A compromise is an agreement reached by mutual consent, a negotiated settlement with or without sacrifice component on the concerned parties to the dispute.
- *Write-Off:* Any asset, which does not contribute any income to the bank or its continuation in the balance-sheet, was deemed to be undesirable for its continuity on the asset side. It was done when it became clear that there was absolutely no chance of recovery in the account.
- *Purchase and Sale of NPAs:* It is a sale and purchase of non-performing assets among banks. This provides a secondary market for the non-performing assets.

Legal Measures

- *LokAdalat:* It is a process of administering justice without resorting to filing a suit. Here, settlement is arrived with mutual consent.
- *Civil Suit/DRT:* Cases involving Rs 10 lakhs and above should be filed with the DRT and below Rs 10 lakhs were to be filed with the civil court.
- *SARFAESI Act:* This act is an effective tool in the hands of the bank to enforce the security interest and recover the dues, thereby reducing NPAs.
- *Public Money Recoveries Act:* This Act authorises the recovery of the dues of banks as a recovery of arrears of land revenue.

Annexure VI

Distribution of NPA Accounts

NPA Amount	*Number of Account*	*Percentage of Total NPA Account*
Up to Rs 1 Lakh	42103	19.48
Up to Rs 25 Lakhs	164067	75.93
Up to Rs 1 Crore	7421	3.44
More than Rs 1 Crore	2474	1.15
Total	216065	100.00

Amount Outstanding in NPA Accounts

NPA Amount	*Percentage of Total NPA Amount*	*Percentage of Total NPA Account*
Up to Rs 25 Lakhs	6.72	95.42
More than Rs 25 Lakhs	93.28	4.58

Annexure VII (a)

Home Loan

A bank had sanctioned housing loan of Rs 7 million to Mr XYZ for direct purchase of a flat. The branch disbursed the full amount of the loan through a pay order in the name of the seller, Mr A (impersonator) in October 2014, who had, in the same month, opened a savings account at another branch of the same bank, to which he credited the proceeds of the loan. The bank had released the loan amount without ensuring registration of sale deed as the mortgage was to be available to the bank only after registration of the flat. At the time of registration of sale deed, both the borrower and the seller did not turn up. It was found that the borrower and seller had colluded and submitted false documents.

Mr XYZ availed the housing loan by submitting forged title deeds of the mortgaged property.

The borrowers were sanctioned housing loans aggregating Rs 140 lakh by a bank. The repayment of loans stopped after payment of 5-6 instalments. During follow-up for recovery of the advance, the bank learnt that a few DDA flats in New Delhi belonging to person(s) staying outside Delhi/abroad had remained locked for some time which had been provided to the bank as security by impersonating the real owners through fake title deeds. The owners, with the intention to either sell their flats or let out on hire, had left the flat keys along with the copy of the title deed of their flats with the local brokers. Fraudsters target such vacant flats, approach the brokers posing as prospective buyers/tenants and manage to obtain copies of the deeds. They then fabricate the title deed by changing the photograph of the owner(s) and approach banks for finance posing as prospective buyer(s).

In this case, they also obtained the keys from the brokers and took the bank officials to the DDA flats for inspection. After sanction of the loan, they submitted fabricated sale deeds to the bank. Other documents such as voter ID, PAN card for proof of present address and other required papers submitted to the bank were also fabricated. The persons (sellers) who impersonated the flat owners also belonged to a group of fraudsters. They encashed the cheques/pay orders issued towards loan proceeds by opening a saving bank account in the beneficiary name, either in the same bank or in some other bank. The proceeds were withdrawn over the next 10 to 15 days and subsequently the fraudsters left the place.

Mr XYZ availed the housing loan by submitting fake bills of construction. Nothing was constructed on site.

Findings

- The borrower claimed part amount on different dates informing about completion of construction of the house in stages. The branch disbursed the loan amount in stages and got a report certifying completion of construction from an architect. There was no construction at the given site.
- The loan application form was not bearing photograph of the borrower. The seller was an impersonator.
- ITRs/financial statements were not cross-verified with the IT Department and with originals.
- Warning signals *viz.* lower score of CIBIL, overdue with other banks and many credit inquiries with various banks were disregarded.

- Equitable mortgage was created on the basis of forged documents.
- In case of purchase of ready house from the seller, a DD was issued in favour of the seller which was deposited and encashed by the seller but the property was not purchased by the borrower.
- The sale deed was executed through a power of attorney (POA) holder of the seller and the POA was subsequently found to be a fake since the true owner had never executed any POA.
- Submission of fake 'No Dues Certificate' and 'NOC' of another Bank by the applicant based on which the loan was sanctioned and EM was created on fake title deeds.

Annexure VII (b)

Car Loan Cases

In case of 21 car loan accounts, borrowers submitted quotations issued by XYZ (not an authorised dealer) to avail a car loan. XYZ encashed the banker's cheque issued towards disbursement of loan through its current account with a small cooperative bank and siphoned off the funds in connivance with the borrowers but did not supply any car. Now, XYZ is not traceable on the given address. Some miscreants availed the car loan by impersonation and submission of fake KYC documents. A bank had sanctioned 12 car loans to different individuals amounting to Rs 12.53 million. When the officials of the branch were following up the NPA accounts in car loans for recovery, it was noticed that the vehicles were not produced for inspection and on further probing it was revealed that the invoices, RC book and insurance copies submitted by the borrowers were fake and that no vehicles were purchased. Apparently, upon sanction of car loans to borrowers, all the drafts were handed over by them to a person who opened a current account at another bank in the fictitious name of a dealer and all the drafts were encashed by him.

A bank had sanctioned four car loans amounting to Rs 5.34 million against hypothecation of cars. The accounts turned NPA soon thereafter and during follow-up, assets were not found. It was found that the borrowers, after the bank's hypothecation charge was duly noted with the RTO, transferred the registration of the vehicles from RTO Nagpur (Rural) to RTO Nagpur (Urban) and got the hypothecation charge cancelled by submitting fake NOC to the RTO and then sold the vehicles. The borrowers were also not available at the recorded address.

Findings

- Genuineness of pro-forma invoices/tax invoices was not established by verifying the concerned authorised car dealers.
- Margin of the car loan either not recovered or not routed through the account.
- Most of the borrowers were not living at their recorded address.
- Employers of borrowers in some cases were non-existent.
- The car dealer's showroom was not available at the given address as given on the pro-forma invoice submitted to the bank.
- The car dealers dealt with different models of cars other than the one mentioned in the pro-forma invoice.
- KYC documents/income proof was fabricated.
- Copies of insurance and registration certificate are not on record. The borrowers/ guarantors are not traceable and the cars are not available for verification.

- Borrower submitted fake registration certificate to bank. Assets were not got verified by the branch.
- Genuineness of financial statements, on the basis of which the credit facility was sanctioned, was not verified.
- Forged bills and receipts were submitted by the borrower to the branch.
- Asset verification was carried out without verifying the engine/chassis number of the vehicle with invoice, registration book, etc.
- The borrower managed to remove the hypothecation charge of the bank on the vehicle on the basis of forged documents, thereby resulting into sale of such a vehicle without repaying the bank's dues and satisfying charge of the bank.

Annexure VII (c)

Education Loan

Mr XYZ was sanctioned education loan of Rs 1.50 lakhs for pursuing MCA from CCS, Meerut. He had left his home and now was not traceable. Ms XYZ was sanctioned education loan of Rs 3.50 lakhs for pursuing BDS. She was a minor at the time of sanctioning of the loan. Now, her parents were not repaying the loan. XYZ was running her clinic but not willing to pay. Ms ABC availed loan of Rs 4.5 lakhs for pursuing MBA. Her parents were working as senior government officials. No credit is received in the account. The branch informed that compromise was under process and recovery of Rs 3 lakhs was expected.

Findings

Moral hazard was the major concern in this segment.

- No unique ID of the student borrower was available with the branch. Hence, none of the default was reported to CIBIL.
- Most of the borrowers were not living at their recorded address,
- Borrowers knew that it was difficult to recover the amount from the student borrowers. Hence, they were reluctant to pay.
- In spite of having capacity to repay the education loan, the borrowers were forcing for a compromise at 40-50 per cent of the outstanding amount.

Annexure VIII

1. To verify the genuineness of balance-sheet (private or public limited companies): Website: www.mca.gov.in

   FAQs on how to view the public documents on MCA portal:

   www.mca.gov.in/MCA21/dca/WebHelp/11_3_How_can_I_view_ public_documents _of_a_company_or_LLP.htm.

2. To verify Permanent Account Number (PAN) details:

   Visit: www.incometaxindiaefiling.gov.in

   Click 'Know your PAN' tab. Enter date of birth/incorporation and name.

   If we have the PAN, we can also verify the name of the PAN holder.

3. To verify whether the auditor signing the balance-sheet holds a valid certificate of practice:

   Website: www.icai.org

   'Members' tab; Members directory search; Search members' database by membership number; Enter membership number of the auditor.It also indicates whether the chartered accountant holds a certificate of practice or not.

   - *CIBIL Verification:* Website www.cibil.com
   - *CERSAI: Website:* www.cersai.org.in. Mortgaged property can be verified/ searched from this website.
   - *ECGC Defaulters' List:* Website: www.ecgc.in. Exporter and importer verification can be done (user id and password to be obtained from ECGC).
   - *Verification of account in RBI portal (Special Mention Account):* The RBI has started better information-sharing among banks. This information is available with administrative offices.
   - *Google Search:* It is also advisable to search about the borrower on Google for general enquiry and view any latest news or information available.
   - *Voter ID search:* Website: http://electoralsearch.in

     a. Click search by Epic No. tab

     b. Enter EPIC No.

     c. Enter state

     d. Enter code (captcha).

     e. Details of voter now can be verified.

Annexure IX

The Sisters' Case

Personal Details

Avantika was a bright student and she did her schooling from Delhi International School. She scored 84 per cent in Class X and 87 per cent in Class XII. Her father, Mr Pawan Jain, was a businessman in ChandniChowk and mother Rajni Jain was a homemaker. Their residence was at Uttamnagar, Delhi. She had only one sister named, Renuka who was pursuing MBA from Amity University Noida. Renuka was an average student and she also did her schooling from Delhi International School. She scored 64 per cent in Class X and 62 per cent in Class XII.

Loan Details

Avantika was sanctioned education loan of Rs 2 lakhs for pursuing B Tech from MDU, Rohtak. Renuka was sanctioned education loan of Rs 1.50 lakhs for pursuing MBA from Amity University, Noida.

Inspection Details

Inspection of residence and workplace was conducted at the time of sanctioning the loan. The house and the shopboth were taken on rent. Thereafter, till the start of repayment in the account, no inspection took place. As per the inspection report of that period, no one was available at the residence and the whereabouts of the borrower/guarantors were not available. The branch head gave the case to a detective agency to find out the new address of the borrower and her whereabouts. However, the detective agency could not make much headway in the case and gave a negative report that the borrower was not traceable.

Annexure X

Procedure to Trace Borrowers

- To obtain CIBIL report we should have unique ID of the borrower/guarantor.
- One such method is the Income Tax website.
- Visit https://incometaxindiaefiling.gov.in/e-Filing/Services/KnowYourPanLink.html. Enter date of birth of the borrower and his/her name in the required field that will give his PAN card number (very helpful in education loan accounts as students do not possess PAN card at the time of sanction of loan).
- Then, obtain the latest CIBIL report of the account which provides his/her latest address, contact number, e-mail address, employment status, etc. by putting user ID and password for CIBIL report purposes as per information already with the branches. The report will also give the last date of enquiry by the borrower with other financial institutions.
- The address available in the CIBIL report may be crosschecked with social media like Facebook, Twitter, LinkedIn, etc, for being doubly sure that the person under reference is the required borrower.
- Call on all the numbers shown in the CIBIL report.
- Crosscheck from the employer (obtained as above) that the person is employed with them.
- The various details given on social websites like Facebook, LinkedIn, etc. should be crosschecked from the details available in the file of the borrower, e.g. if the name of the school in the social site and in our file is the same , there is very high probability that the person detailed in the social site is the same borrower.

After experimenting over a period of time, the staff members will be more experienced in locating such untraceable borrowers with the help of CIBIL report and social websites.

Trainer's Note

1. *Learning Objectives*

- ❑ Current banking scenario and reasons for focus on recovery.
- ❑ Criteria for classification of accounts as NPAs.
- ❑ Orthodox methods of recovery and their limitations.
- ❑ Social media - a tool for tracing the untraceable borrowers.
- ❑ Importance of CIBIL/Credit Bureau.
- ❑ Methods to verify authenticity of KYC documents.
- ❑ Procedure to find the whereabouts of KYC-compliant borrowers.

2. *Suggested Reading*

A. Current Banking Scenario and Reasons for Focus on Recovery

- ❑ Issues in Banking Today, Speech at CII's first banking summit by Dr. Raghuram Rajan, Governor, Reserve Bank of India at Mumbai on February 11, 2016.
- ❑ Asset Quality Challenges in India: Diagnosis and Prognosis, Keynote address delivered by Shri S S Mundra, Deputy Governor, Reserve Bank of India, at the Edelweiss Credit Conclave held in Mumbai on April 28, 2016.

B. Criteria for Classification of Accounts as NPAs

- ❑ Master Circular, Prudential Norms on Income Recognition, Asset Classification and Provisioning Pertaining to Advances, RBI (2015).
- ❑ Master Circular, Guidelines for Relief Measures by Banks in Areas Affected by Natural Calamities, RBI(2015).
- ❑ Master Circular on Wilful Defaulters, RBI (2015).

C. Traditional Methods of Recovery and their Limitations

- ❑ Banks, Debt Recovery and Regulations: A Synergy, Talk delivered by Shri R Gandhi, Deputy Governor, RBI, on December 29, 2014 at the Workshop for Judges of DRATs and Presiding Officers of DRTs.
- ❑ Credit Monitoring, Legal Aspects and Recovery of Bank Loans by D D Mukherjee. Chapter - Recovery through SARFAESI Act, Recovery through Debt Recovery Tribunals, Other Options for Recovery, Compromise and Write-Off, The Last Resort.

D. Social Media - A Tool for Tracing the Untraceable Borrowers

- ❑ https://www.facebook.com/help/460711197281324/
- ❑ https://www.linkedin.com/help/linkedin/answer/302/searching-on-linkedin?lang=en

E. Importance of CIBIL/Credit Bureau

- ❑ https://www.cibil.com/help-center
- ❑ Understanding CIBIL: Functions, Product and Services, published by CIBIL.

F. Methods to Verify Authenticity of KYC Documents.

- ❑ Read Annexure 1 and for any doubt corresponding website can be accessed.

G. Procedure to find out the Whereabouts of KYC – Compliant Borrower

- ❑ Read Annexure II.

Teaching Plan

1. Current Banking Scenario and Reasons for Focus on Recovery

The class can be divided into six groups. Then brainstorming can be done on the asset side of the balance-sheet of various banks (two private sector banks, one SBI, two nationalised banks and one foreign bank). Reasons and effects of NPA can be discussed in detail.

2. Criteria for Classification of Accounts as NPAs

The above mentioned master circular of the RBI can be provided as handout on the very first day of the programme and doubts can be cleared later. A quiz can be arranged on NPA norms.

3. Traditional Methods for Recovery and their Limitations

Benefits and shortcomings of each method can be discussed. It can also be shown that even a decree in favour of bank is not a guarantee of recovery. Hence, new methods should be explored.

4. Social Media – A Tool for Tracing the Untraceable Borrowers

Importance of social media should be discussed and help content can be shown. Various filter criteria can be shown.

5. Importance of CIBIL/Credit Bureau

The importance of CIBIL/Credit Bureau is increasing day by day. Some banks have already linked their rate of interest with the CIBIL score. Reading CIBIL report should also be taught.

6. Methods to Verify Authenticity of KYC Documents

Live demonstration of each website can be shown and its usage can be taught.

7. Procedure to find out the Whereabouts of KYC – Compliant Borrowers

Live demonstration of searching a KYC – compliant borrower can be shown. It requires little practice and after that the faculty will be experts in searching the person.

Author's View

This case requires minimum three sessions and can be extended to a full day. Focus should be given on the limitations of existing methods and how digital tools/social media can give us additional advantage during negotiations and recovery. It is an era of globalisation where social media has helped people to connect with each other. The young generation is invariably present on various social media platforms like Facebook, LinkedIn, etc. Most of the borrowers were absconding (in branch records) but all of them (except fraud case) were available on these platforms and their location and current organisation could be traced easily. Credit monitoring of retail loan should include checking of social media profile of these borrowers to keep a close watch on their activities.

In most of the cases, default was not reported to CIBIL. CIBIL is a very important tool for taking decisions in the retail loan segment. If we start reporting education loan default to CIBIL then it would create pressure on these defaulters to pay back the loan amount to the bank. Later on when these defaulters would approach a bank for any car or housing loan, they would not be able to get the loan till they pay the amount in full to the bank. Thus, the problem of moral hazard could be addressed. It should be made mandatory that even if a compromise is made in any retail loan, it should be reported to CIBIL. Some borrowers were ready for compromise at 50 per cent of the outstanding amount.

Borrowers also wanted that reporting of their names to CIBIL should not be done in case of any compromise. Thus, they were trying to bypass the system by getting a clean chit through payment of only 50 per cent of the amount. As a prudent banker, we might accept the offer (depending on the facts) but at the same time reporting to CIBIL may help in additional recovery in future. Procedure to trace the borrowers using social media/PAN number, etc. may be taught.

Foreign Letter of Credit

Ms Tajashree Pawaskar

Laxmi Impex Ltd. was incorporated on November 26, 1970 with the main object to carry on the business of manufacturing, trading, selling in all types of Steel and Steel products. The company was promoted by Late Shri Shivraj along with his family having long business experience and has been in this business line for last four decades. Presently, it has two manufacturing units located at :

(a) Ghaziabad, UP, having manufacturing capacity of Steel Bar/Wire Rods and Steel Billets of 185000 TPA and 50000 TPA respectively

(b) Sambalpur, Orissa, having manufacturing capacity of Sponge Iron and Steel Billets of 200000 TPA and 210000 TPA respectively. The company has also installed 20 M Wcaptive power plant at Orissa to take care of ower requirement of the plant. During the 2015-2016, company faced the following problems:

1. Significant volatility in cost of raw materials especially iron ore;
2. Acute rise in energy/power cost;
3. Insufficient working capital limits with untied portion;
4. Increase in interest rate on bank borrowing.

Following limits are sanctioned to the company:

CC limit : Rs. 7 crores

On May 7, 2016, Mr Rahul, third generation i.e. grand son of MrShivraj, came from London to Mumbai. He completed his MBA rom London and joined Laxmi Impex Ltd., on June 2016. Mr Rahul is young, vibrant and energetic professional with innovative ideas. While working in the company, he studied its various reports and realized that the same has been relying too much on few clients for business. And, he firmly felt that this could be detrimental to his company's survival in the present competitive world. He then did the survey of the European Markets and also did four business trips to Europe. He shortly developed business relations with few customers in Europe and was successful in getting orders from them. This was a new turn in the Company business and Mr Rahul firmly believed that some thing good was in store for the company. During finalization of the order, Mr Rahul insisted on settlement of payment through Letter of Credit as it was their company's first transaction with overseas buyer. Next day, Mr Rahul went to his branch and discussed the matter with the branch manager.

I. Discussion Point 1: Benefits of LC

Laxmi Impex Ltd. entered into a sales contract with Cassa De Steel, European buyer for a credit period of 90 days from shipment date for Euro 50000 for the supply of Steel Bars. As soon as the contract was finalized, Cassa De Steel applied for LC according to the sales contract and sent the LC for Euro 50,000 to the bankers of Laxmi Steel. As soon as the LC

Ms Tejashree Pawaskar (tejashree.pawaskar@rediffmail.com) Chief Manager, Bank of Baroda.

was advised to Laxmi Steel, it checked the contents as per the sales contract and found it was perfectly ok. Accordingly, Laxmi Impex started the plans to start manufacturing process so as to dispatch the goods on time. But as the order was quite big which involved large amount of money for procuring raw material, processing, manufacturing, etc, Laxmi Impex decided to avail of loan from the bank so that the production cycle of the company does not get hampered. So, Mr Rahul went to his bank and explained his requirement of funds along with the LC received from the overseas buyer. Bank sanctioned him limits for Pre-shipment and Post-shipment finance. Details of figures for calculation of Packing Credit limit are as under:

The company projected a turnover for the ensuing year as Rs.2800 lacs, out of which 40 per cent would be of export sales. For this, it consumes 40 percent of raw materials for manufacturing exportable goods and the time taken from raw material stage to submission of export document to the bank is as follows:

Total raw material consumed Rs. 2100 lacs

Procurement of raw materials; 30 days

Processing Time : 23 days

Transportation, preparation of documents: 15 days

II. Discussion Point 2: How much packing credit limit can Laxmi Impex get sanctioned from the bank?

After disbursement of Packing Credit, Laxmi Impex started the production and ultimately the goods were dispatched to Europe. Later the company submitted the 1st export documents to his bank (EUR 50000) against which post-shipment credit was granted and Packing Credit was liquidated. Further, the documents were sent to the LC Opening Bank. In the mean time, Laxmi Impex got another deal from Grande Steel for EUR 75000 which was also finalized and got another LC from their bankers for EUR75000. Accordingly, Laxmi Impex availed of PC for the same and later, submitted the 2nd set of export documents for the same to their bankers. On submission of the 2nd set of export documents for negotiation the bank observed the following:

1. Laxmi Impex approached the bank on 11st August for negotiation of export documents under the letter of credit containing the expiry date as 'middle of August'.
2. The letter of credit covering 100 steel bars prohibits partial shipments. The exporter presents 2 sets of Bills of Lading each covering 50 steel bars on board. The 2 sets of Bill of Lading evidencing shipment on board bear the dates 14th and 15th July respectively.
3. Laxmi Impex submitted documents for EUR 75000 under irrevocable LC stipulating the amount as 'about EUR 75000'.

III. Discussion Point 3: Has Laxmi Impex presented the 2nd export bill of EUR 75000 in order?

After a week's time, Laxmi Impex got a call from their bankers that the 1st export bill of EUR 50000 was rejected by the overseas banker stating the following discrepancies (through SWIFT message MT734):

1. The LC stipulates shipment latest by 15th August. The Bill of Lading presented bears the date 16th August, as 15th is a public holiday in India.
2. The insurance policy is dated 20th August but, the date of Bill of Lading is dated 16th August
3. A bill of exchange accompanying three Bills of Lading dated 1st August, 7th August and 10th August is presented under LC which prohibits partial shipment. Incidently, all the Bills of Lading evidence shipment by the same ship through different ports.
4. The LC is expressed in EUR, but the insurance policy is stated in INR although it fully insures the shipment in all respects
5. The goods released by the importer are defective.
6. The LC is silent on transhipment. The Bill of Lading has a transhipment clause.

Mr Rahul immediately went to his bank and was surprised with the number of discrepancies as pointed out by the overseas banker for refusal for payment of export document. He asked his banker to give a strong reply to the overseas banker and seek the export payment.

IV. Discussion Point 4: Will the bankers of Laxmi Impex be successful in receiving payment of 1st export bill of EUR 50000?

During this period i.e 14th August a 3rd export bill under LC was submitted by Laxmi Impex for EUR 60000 for negotiation which expired on 10th August. The reason offered by Laxmi Impex is 'There was a complete strike in the bank from 5th August to 13th August, and though all the documents were complete and ready, it was impossible to present them before the credit expired'.

V. Discussion Point 5: Is the stand taken by Laxmi Impex correct in case of the 3rd export bill?

In the month of August 2016, Mr Rahul also had a plan of diversifying its business in trading activity which had great scope in US market. Accordingly, he worked out a plan for the same wherein Laxmi Impex will buy 'Modular Kitchen Sets' from Star Ltd, India and then, process

the same and pack the goods under their name and export the same to US buyers. Mr Rahul was successful in getting two such orders from US. But there was liquidity problem which MrRahul was unable to solve for which he went to his bank and discussed. He explained his entire trading activity plan to his banker. He also made his banker to understand that he required funds to buy modular kitchen sets from Star Ltd, India or at least he should be able to give some sort of guarantee to Star Ltd that Laxmi Impex would honour its commitment. The banker suggested that Letter of Credit is the sure shot way to solve his problem.

VI. Discussion Point 6: Which you think is the best option available in LC for Laxmi Impex and justify by stating valid reasons.

Accordingly, Mr Rahul explained his plan to his banker. Accordingly, Laxmi Impex, India, will be playing a role of a Trader or a Middleman (Intermediary Party) and will be supplying the goods (modular kitchen sets) to the Importer, Steelman Inc in USAwhose bankers is a Worldwide Bank, USA. But Laxmi Impex will be buying the goods from Star Ltd, India and Moon Ltd, India who in turn will buy the same from other small Suppliers *viz.* Dhani, India and Mani, India and finally supply them to Steelman Inc.

VII. Discussion Point 7: How can Laxmi Impex plan out the entire transaction under LC, without using any funds in buying the goods from Star Ltd, India and Moon Ltd, India in a secured manner and earning a profit of 25 percent in the trade transaction? And, what are the various parties involved in the above transaction?

The bank manager explained the entire operations involved in the above transaction. After understanding the banker's viewpoints, Mr Rahul had the following doubts :

1. What if the LC does not meet the transferring bank's criteria?
2. What parameters can be changed when transferring a LC?
3. Will the supplier (Star Ltd, India and Moon Ltd, India) and buyer (Steelman Inc.) be able to identify each other?
4. Can transferred LC be transferred at the request of Star Ltd. to any subsequent beneficiary (Dhani, India)?
5. If LC is transferred to Star Ltd. and also to Moon Ltd., then will the rejection of an amendment by Star Ltd invalidate the acceptance by Moon Ltd ?

VIII. Discussion Point 8: How the banker would clarify the above doubts raised by Mr Rahul?

Trainer's Note

I. Learning Objective:

(a) To understand how a Letter of Credit (LC) plays an integral part in facilitating international trade while providing a secure and reliable means of payment. The LC is a bank undertaking of payment separate from the sales or other contracts on which it is based. In simple terms, it is a written undertaking given by the importer's bank, on behalf of importer, to the exporter bank, favouring the exporter that, if the exporter bank gives the importer bank, the required set of documents within the prescribed time limit, then it (importer bank) will pay the exporter bank

(b) To understand the benefits of LC to the Exporter/Seller.

(c) To make the participants understand the importance of LC, the LC mechanism, the usage of UCP 600 and its implications

II. Suggested Reading:

(a) RBI Master circulars on Export of Goods and Services

(b) RBI Master circulars on Import of Goods and Services

(c) RBI Master Directions on Export of Goods and Services

(d) RBI Master Directions on Import of Goods and Services

(e) FEMA 1999 on Exports

(f) FEMA 1999 on Imports

(g) FEDAI rules on Exports and Imports

(h) UCP-600 by ICC.

III. *Teaching Plan:*

(a) Start-up simple questions for discussion 5 minutes):

What is a trade and how are trade transactions settled four methods of Advance Payment, Open Account, Bills on Collection and Letter of Credit) ?

Has anybody seen a Letter of credit or has any body dealt in it or did any transaction in Letter of credit?

What is the difference between inland LC and foreign LC. ?

(b) Introductory Questions :15 minutes

(i) How is Letter of Credit better than other three methods of payment settlement as discussed above under start up questions.?

(ii) Advantages and Disadvantages of LC for the exporter and importer.

(iii) Risks involved in LC transactions from the point of view of the issuing Bank and the various ways of mitigating the risks involved in it (Buyers Risk, Sellers Risk, Goods Risk, Country Risk and Exchange Risk).

(c) Discussion Areas : 10 minutes each discussion point, so total 80 minutes

(i) Discussion Point 1: Benefits of Contractual obligations "evidenced by documentary compliance"

1. LCs open the door to international trade by providing a secure mechanism for payment upon fulfillment of contractual obligations.
2. A bank is substituted for the buyer as the source of payment for goods and services exported.
3. The issuing bank undertakes to make payment, provided all the terms and conditions stipulated in the LC are complied with
4. Financing opportunities, such as pre shipment finance secured by LC and /or discounting of accepted drafts drawn under LC are available.
5. Bank expertise is made available to help complete trade transaction successfully.

(ii) Discussion Point 2:

1. How much Pre shipment Credit limit (PC limit) can Laxmi Impex get sanctioned from the bank) , Procurement of raw materials 30 days and Processing Time 23 days

   Transportation, preparation of Documents : 15 days

   Total number of days : 68 days

   Total number of months: 2.25 months

   40 percent of Raw material consumed = 840 lacs

   Rotation of LC 12 /2.25 = 5.333 times

   Packing Credit required 840/5.333 = 157.50 lacs

   Hence, Packing Credit limit Rs. 157.50 lacs Minus Promoter's contribution (Margin) *(iii)* (Discussion Point 3 : Has Laxmi Impex presented the 2nd export bill of EUR 75000 in order?)

1. The documents in question are in order as per Article 3 -

   Interpretations of UCP 600 which states as under-

   The terms 'beginning', 'middle' and 'end' of a month shall be construed respectively as the 1st to 10th, the 11th to 20th and the 21st to the last day of the month, all dates inclusive.

2. The bills in question will be accepted as a good tender as per Article 31-

   Partial Drawings and Shipment of UCP 600 which states as under-

   A presentation consisting of more than one set of transport documents evidencing shipment commencing on the same means of conveyance and for the same journey provided, indicating the same destination will not be regarded as covering a partial shipment, even if they indicate different dates of shipment or different ports of loading, places of taking in charge or dispatch.

3. The documents under question will be negotiated as per Article 30 of UCP 600 which states as under:

   The words 'about' or 'approximately' used in connection with the amount of the credit or the quantity or the unit price stated in the credit are to be construed as allowing a tolerance not to exceed 10 percent more or 10pct less than the amount, or the unit price to which they refer. Hence, the 2nd export bill of EUR 75000 is in order.

(iv) (Discussion Point 4: Will the bankers of Laxmi Impex be successful in receiving payment of 1st export bill of EUR 50000?)

1. The Bill of Lading will not be a good tender and will not be accepted as per Article 29 a and b of UCP 600 which states as under:

   If the expiry date of a credit or the last day for presentation falls on a day when the bank to which presentation is to be made is closed for reasons other than those referred in Art 36 (Force Majeure), the expiry date or the last day for presentation, as the case may be, will be extended to the first following banking day Article 29 b. But, the latest date of shipment will not be extended as a result of the above sub article.

2. The insurance policy in question will not be a good tender and will not be accepted as per Article 28e of UCP 600 which states as under:

   The date of the insurance document must be not later than the date of shipment, unless it appears from the insurance document that the cover is effective from a date not later than the date of shipment.

3. The documents will be accepted for negotiation, if otherwise in order, as per Article as per Article 31 - Partial Drawings and Shipment of UCP 600 which states as under :

   A presentation consisting of more than one set of transport documents evidencing shipment commencing on the same means of conveyance and for the same journey, provided they indicate the same destination will not be regarded as covering a partial shipment, even if they indicate different dates of shipment or different ports of loading, places of taking in charge or dispatch.

4. The insurance policy in question will not be accepted as per Article 28 f i of UCP 600 which states as under:

   The insurance document must indicate the amount of insurance coverage and be in the same currency as credit.

5. The payment can be enforced against the openers of the LC as per Article 5 of UCP 600 which states as under:

   Bank deals with documents and not with goods, services or performance to which the documents may relate.

6. The Bill of Lading in question will be accepted as per Article 20 c ii of UCP 600 which states as under:

   A Bill of Lading indicating the transhipment will or may take place is acceptable, even if the credit prohibits transhipment, if the goods have been shipped in a container, trailer or LASH barge as evidenced by the Bill of Lading. Hence, as per point no.1, 2, and 4, the bankers of Laxmi Impex will not be successful in receiving payment of 1st export bill of Euro 50000.

(v) Discussion Point 5: Is the stand taken by Laxmi Impex correct in case of 3rd export bill?.

1. The stand taken by Laxmi Impex in case of 3rd export bill is not correct as per Article 36 of UCP 600 which states as under :

   A bank assumes no liability or responsibility for the consequences arising out of the interruption of its business by Acts of God, riots, civil commotions, insurrections, wars, acts of terrorism, or by any strikes or lockouts or any other causes beyond its control.

   A bank will not, upon resumption of its business, honour or negotiate under a credit that expired during such interruption of its business.

(vi) Discussion Point 6: Which you think is the best option available in LC for Laxmi Impex and justify by stating valid reasons.

The best option available in LC for Laxmi Impex is Transferrable Letter of Credit for following reasons:

A Transferrable LC is used in cases where there are three parties to a transaction, an Importer (Buyer), Exporter (Actual Supplier), and an intermediary party, such as a broker, who is responsible for arranging the sale.

In such a transaction, the intermediary party (Laxmi Impex) requests a LC from the Importer as protection against non- payment The exporter(Actual Supplier i.e Star Ltd, India), in turn, ants assurance from the intermediary party that payment will be made, and will also request a Letter of Credit.

It may be the case, however, that the intermediary party (Laxmi Impex) has little working capital or does not have access to a line of credit with its bank to issue a separate Letter of Credit to the Exporter (Star Ltd, India). As an alternative, the intermediary party(Laxmi Impex) may provide such assurance to the Exporter Star Ltd, India) by transferring over a portion of the Letter of Credit it received from the Importer. This is termed a Transferable Letter of Credit.

To be able to transfer a Letter of Credit, the intermediary party (Laxmi Impex) must specifically request a Transferable Letter of Credit from the Importer. The

Letter of Credit must nominate a bank, generally the Advising Bank, who is authorized to effect a transfer.

The intermediary party (Laxmi Impex) would be the Beneficiary of the Letter of Credit and, in a Transferable Letter of Credit transaction, is referred to as the First Beneficiary. The First Beneficiary would then ask the Transferring Bank to transfer, in part or in full, its rights under the etter of Credit to the manufacturer of the goods, who is referred to as the Second Beneficiary (Star Ltd, India).

A Transferable Letter of Credit may be transferred only once; therefore, a Second Beneficiary is unable to transfer a portion of a Transferable Letter of Credit to a third beneficiary. It may, however, be transferred to more than one Second Beneficiary, in which case the L/C must state that partial shipments are allowed.

(vii) (Discussion Point 7 : How can Laxmi Impex plan out the entire transaction under LC without using funds in buying the goods from Star Ltd, India and Moon Ltd, India in a secured manner? And what are the Various parties involved in the above transaction?)

The following is a simplified mechanism of a Transferable Letter of Credit transaction as per Article 38 of UCP 600 along with the parties involved in it:

Importer: Steelman Inc., USA

Intermediary Party (Middleman): Laxmi Impex, India

Supplier: Star Ltd, India and Moon Ltd, India

Issuing Bank: World Wide Bank, USA

Transferring Bank: Big Bank, India

As per Steelman Inc.USA instructions, World Wide Bank, USA will issue a Transferable Letter of Credit in favour of Laxmi Impex who is acting as the intermediary party in the trade transaction. This ransferable Letter of Credit is in the amount of USD $100,000 and BigBank is authorized and willing to do the transfer.

The description of goods is 50 modular kitchen sets at USD $2000 per set. Once Laxmi Impex as the First Beneficiary receives the Letter of Credit, it requests Big Bank, India to transfer USD $75,000 to Star Ltd, India Supplier Company, stating the same quantity of goods, 50 modular kitchen sets, but at USD $1500 per set.

Big Bank, India will advise the transfer has been made to Star Ltd, India Supplier Company Ltd, who now becomes the Secondary Beneficiary of the Letter of Credit. Once Star Ltd, India Supplier Company Ltd has shipped the goods, it presents documents in accordance with the Transferable Letter of Credit,along with its draft for USD $75,000, to Big Bank India. Big Bank, India will then notify Laxmi Impex of the presentation.

Laxmi Impex will present its own invoice and draft showing a value of USD $100,000 in order to comply with the original Letter of Credit. Big Bank, India checks the documents then (if all in order) substitutes these documents for those presented by Star Ltd, India Supplier Company Ltd and forwards the documents to WorldWide Bank, USA.

Assuming all documents comply with the L/C terms, Big Bank, India receives USD$100,000 and pays USD $75,000 to Star Ltd, India Supplier Company Ltd and USD $25,000 to Laxmi Impex

(viii) Discussion Point 8: What is the clarification for the doubts raised by Mr Rahul)

1. What if the L/C does not meet the bank's transfer criteria?

   The bank retains the right to decline a transfer request. It may consent if certain terms and conditions of the letter of credit are amended to meet its requirements. Any amendment to a letter of credit is subject to agreement of the buyer, the buyer's bank, and the beneficiary who is requesting the transfer. Banks retain the right to decline any transfer/ request. As per Article 38 a of UCP 600, the fact that a credit may be stated to be transferable, does not bind the nominated transferring bankor the issuing bank to effecting any transfer. A bank that is nominated to transfer a credit is under no obligation to effect a transfer and is able to indicate under what conditions they would be willing to consider effecting the transfer

2. What can be changed when transferring a Letter of Credit?

   Article 38 g of the UCP 600 limits changes to the following:

   - The L/C amount may be reduced.
   - Unit prices may be reduced.
   - The expiry and latest shipping dates may be curtailed.
   - The time period after the date of shipment for presenting documents to the bank may be curtailed.
   - The name of the beneficiary is substituted for the name of the applicant (buyer), but if the applicant's name is required to be stated in any document other than the invoice, this requirement must be adhered to.
   - If an insurance document is required, the coverage may be increased to provide coverage as required by the original L/C.

3. Will the supplier and the buyer be able to identify each other?

   Probably so, even if the bills of lading do not give the buyer as "consignee" and the "notify arty" is shown as the buyer's customs Broker, all of the seller's documents (except for invoice and raft) are forwarded to the buyer through their banks, and a packing list should have the seller's name and address.

4. Can transferred LC be transferred at the request of Star Ltd. to any subsequent beneficiary (Dhani, India)?

   No. It cannot be transferred at the request of Star Ltd. to Dhani, India as per Article 38 d of UCP 600 which states as under:

   A credit may be transferred in part to more than one second beneficiary provided partial drawings or shipments are allowed. However, a transferred credit cannot be transferred at the request of second beneficiary to any subsequent. The first beneficiary is not considered is not considered to be a subsequent beneficiary.

5. If LC is transferred to Star Ltd. and also to Moon Ltd., then will the rejection of an amendment by Star Ltd invalidate the acceptance by Moon Ltd.?

No, it will not invalidate the acceptance by Moon Ltd, India as per Article 38 f of UCP which states as under :

If a credit is transferred to more than one second beneficiary, rejection of an amendment by one or more second beneficiary does not invalidate the acceptance by any other second beneficiary, with respect to which the transferred credit will be amended accordingly. For any second beneficiary that rejected the amendment, the transferred credit will remain unamended.


NIBM

Dr Sarita Bhatnagar

Dr Sarita Bhatnagar is a faculty member in the Strategic Planning and Marketing Area Group at National Institute of Bank Management, Pune.

She has 10 years of experience in training of Senior Executives in the areas of Financial Services Marketing, Customer Relationship Management, Customer Analytics, Marketing Strategies for Banking Segments, Digital Marketing, Branch Level, Marketing with Focus on Retail and MSME, Ethics in Banking, Trainer's Training Programmes and Leadership Development Programmes.

She has designed and coordinated a number of such Executive Development Programmes for Executives from Indian and Foreign Banks.

She has conducted Research Projects in areas of Bank Marketing, Customer Relationship Management in Banking and Bank Customer Relationships in Micro Small and Medium Enterprises Segment. She has conducted sponsored research and consultancy in areas of Customer Service and SHG Bank Linkage and Bank Business Models.

She has 17 years of experience in teaching Management courses of Marketing, Strategic Management, General Management, Marketing Research and Marketing of Financial Services at post graduate level. She has been Managing Editor of Journal Nirnay and at present is Editorial Committee Member of Journal Vinimaya published by National Institute of Bank Management.

She has published research papers and articles and presented papers in National and International level conferences.

Dr Kaveri

Dr V S Kaveri is a former Professor of Finance , NIBM , Pune. He has been a regular contributor to leading journals in Banking besides being an author of several books. He was associated with several committees/ working groups appointed by Reserve Bank of India. Dr Kaveri was a recognized Guide for doctoral students enrolled with the University of Pune. He was also the Director of Indian Institute of Bank Management, Guwahati.

He can be reached at vskaveri@gmail.com