

# CREDIT DELIVERY

## Chapter 21 Module C ABM By Ashish Sir

### □ DOCUMENTATION IN BANKING & LOANS □

Documentation plays a crucial role in establishing **legal liability** of the **borrower and guarantor** and securing the **bank's interest**.

Proper documentation ensures enforceability in **courts of law** in case of default. ✓

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#### □ Key Aspects of Documentation

□ **Borrowers & Guarantors must sign documents** to establish their liability.

□ **Primary security** (assets created using bank finance) requires the **borrower's signature**.

□ **Collateral security** (additional assets pledged) requires the **owner's signature**.

□ If the **collateral security owner** is different from the borrower, they must **first become a guarantor** before pledging assets.

#### □ Example:

- *Mr. A takes a loan from a bank, pledging his house as collateral. He must sign the loan documents and the mortgage deed.*
- *If Mr. B (his father) pledges his property instead, he must first become a **guarantor** and then sign the mortgage documents.*

## Checklist for Executing Loan Documents

### (a) Stamping of Documents ✓

Documents should be **properly stamped** to ensure legal validity.

**Incorrect stamping** can lead to the document being **unenforceable in court**.

### (b) Execution Date

The **execution date should never be earlier than the stamping date**.

**Date & place of execution** must be clearly mentioned.

### (c) Authority & Capacity to Sign

The **person signing must have legal authority** to enter into a contract.

Companies must have **Board resolutions** authorizing specific individuals.

### (d) Free Will of the Signatory

The signatory must sign the document **without coercion or pressure**.

### (e) Complete Documentation Before Signing

**No blank spaces** should be left in documents before signing.

Any **corrections or overwriting must be authenticated** by all parties.

### (f) Registration with the Registrar of Companies (ROC)

If a **company** is creating a charge on assets, it must **register the charge with ROC within 30 days** of execution.

Non-registration can result in the charge being **invalid against third parties.**

**(g) Registration with Sub-Registrar (if required)**

Some documents (like **mortgage deeds** for property loans) must be **registered with the Sub-Registrar** within a **prescribed time.**

**Example:** *ABC Ltd. takes a loan by mortgaging its factory. The mortgage deed must be registered with the **Sub-Registrar** within the prescribed period, and the charge must be registered with the **ROC** within 30 days.*

### **Summary Table - Documentation in Banking**

<input type="checkbox"/> <b>Aspect</b>	<input checked="" type="checkbox"/> <b>Key Points</b>
<b>Who Signs the Documents?</b> <input type="checkbox"/>	Borrowers & Guarantors
<b>Primary Security Documents</b> <input type="checkbox"/>	Signed by Borrower
<b>Collateral Security</b> <input type="checkbox"/>	Signed by Owner (who must be a Guarantor)
<b>Stamping of Documents</b> <input type="checkbox"/>	Must be Properly Stamped
<b>Execution Date</b> <input type="checkbox"/>	Must not be earlier than Stamping Date
<b>Authority to Sign</b> <input type="checkbox"/>	Person must have legal capacity
<b>Free Will</b> <input type="checkbox"/>	No coercion in signing
<b>Filling Before Signing</b> <input type="checkbox"/>	No blank spaces allowed
<b>ROC Registration</b> <input type="checkbox"/>	Charge must be registered within <b>30 days</b> for Companies

### **Sub-Registrar Registration**



Required for Mortgage Deeds & other specific documents

## **THIRD-PARTY GUARANTEES IN BANKING**

### **What is a Third-Party Guarantee?**

A **third-party guarantee** is a **promise made by an individual or legal entity** to repay a loan in case the primary borrower **fails to do so**.

Banks **stipulate guarantees** from **third parties** as an additional security measure **against default**.

#### **Example:**

- A business owner takes a loan, but the bank requires a personal guarantee from his brother as additional security.*
- A company taking a loan may be required to get a guarantee from its directors or parent company.*

### **When is a Third-Party Guarantee Required?**

- For Individuals or Businesses with Higher Credit Risk**
- For Closely-Held Companies** (Where a few individuals or families hold a majority of shares)
- When the Financial Condition of the Borrower is Weak**
- If the Loan is Unsecured**
- When there is a Delay in Creating a Charge on Assets**

6 For Subsidiaries with a Weak Financial Position (Guarantee from Parent Company)

7 For Companies with Interlinked Finances with Other Entities

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### RBI Guidelines on Third-Party Guarantees

#### (i) Closely-Held Companies

- Personal guarantees of directors may be helpful when shares are **closely held by a family/group**.
- Guarantees should be taken from **principal shareholders** instead of **managerial personnel**.

#### (ii) Ensuring Management Stability

- Even if a company is **not closely held**, guarantees may be taken **to ensure continuity in management**.
- If guarantees are **waived**, the borrowing company must provide an **undertaking** that **no management changes will be made without the bank's consent**.

#### (iii) Public Limited Companies

- Personal guarantees of directors may be required when advances are **unsecured**.

#### (iv) Financially Weak Companies

- If the **financial position or cash generation ability** of a public limited company is **not satisfactory**, guarantees should be obtained **even if the loan is secured**.

#### (v) Delayed Creation of Asset Charge

- If there is a **delay in securing the loan against assets**, a **guarantee can be taken to cover the interim period**.

**(vi) Parent Company Guarantees**

- If a **subsidiary's financial health is weak**, a **guarantee from the parent company** should be taken.

**(vii) Interlocking of Funds**

- If a company's balance sheet shows **financial interdependence with other businesses**, a personal guarantee is necessary.

**RBI Restrictions on Guarantee Commission**

✓ **No commissions, brokerage, or fees** should be paid by the borrower or received by the guarantor.

✓ Banks should **monitor compliance** during periodic inspections.

✓ **Exception:** If the assisted company is struggling, a **guarantee commission** may be allowed to **retain old guarantors** if the new management's guarantee is unavailable or inadequate.

**Summary Table - Third-Party Guarantees in Banking**

<input type="checkbox"/> <b>Condition</b>	<input type="checkbox"/> <b>Requirement of Third-Party Guarantee</b>
<b>Closely-Held Companies</b> <input type="checkbox"/>	✓ Personal guarantee of principal shareholders/directors
<b>Public Limited Companies (Unsecured Loan)</b> <input type="checkbox"/>	✓ Directors' guarantees may be required

<b>Weak Financial Position</b> <input type="checkbox"/>	✓Guarantee required even if the loan is secured
<b>Delayed Charge Creation on Assets</b> <input type="checkbox"/>	✓Temporary guarantee until charge is created
<b>Subsidiary with Poor Finances</b> <input type="checkbox"/>	✓Parent company guarantee required
<b>Interlinked Finances with Other Companies</b> <input type="checkbox"/>	✓Guarantee required
<b>Change in Management</b> <input type="checkbox"/>	✓Undertaking required to avoid sudden changes
<b>Guarantee Commission</b> <input type="checkbox"/>	✗Not allowed (except in exceptional cases)

✓Third-party guarantees enhance banks' security & reduce lending risks while ensuring borrower accountability!

## **CHARGE OVER SECURITIES IN BANKING**

### **What is a Charge Over Securities?**

- A **charge** is a legal right that a **bank or lender** holds over an asset as **security** for a loan.
- If the borrower **fails to repay**, the lender can **take control** of the asset and **recover** the outstanding amount.

#### **Example:**

- A bank grants a **home loan** and creates a **mortgage** over the house.

- A borrower takes a **gold loan**, and the bank **pledges** the gold as security.

### ☐ Types of Charges in Banking

☐ Type of Charge	☐ Type of Security	☐ Example of Security
☐ <b>Mortgage</b>	Immovable Property	Land, Building, Machinery embedded to the earth
☐ <b>Pledge</b>	Movable Assets	Raw Materials, Shares, Stocks, Gold, Jewellery
☐ <b>Hypothecation</b>	Movable Assets	Raw Materials, Motor Vehicles, Standing Crops
☐ <b>Lien</b>	Securities already in possession of the lender	Goods and Securities (except actionable claims & money)
☐ <b>Assignment</b>	Actionable Claims	LIC Policies, Book Debts, Receivables

### ☐ Comparison of Mortgage, Hypothecation, and Pledge

☐ Feature	☐ Hypothecation	☐ Pledge	☐ Mortgage
☐ <b>Meaning</b>	Extended concept of pledge; a charge is created while possession remains with borrower.	Bailment of goods as security for a loan.	Transfer of interest in immovable property for securing a debt.



<input type="checkbox"/> <b>Legal Status</b>	Defined in Sec 2(n) of <b>SARFAESI Act.</b>	<b>Indian Contract Act</b> (Sec 172).	<b>Transfer of Property Act</b> (Sec 58).
<input type="checkbox"/> <b>Applicable To</b>	Movable Goods	Movable Goods	Immovable Property
<input type="checkbox"/> <b>Types of Assets Covered</b>	Stocks, Vehicles, Machinery, Crops	Shares, NSC, KVP, Gold, Materials	Land & Building, Machinery fixed to the earth
<input type="checkbox"/> <b>Possession of Asset</b>	With Borrower	With Bank	With Borrower
<input type="checkbox"/> <b>Rights of Bank to Sell</b>	Can convert into pledge if borrower defaults.	Can sell after issuing a notice.	Can sell after legal process.
<input type="checkbox"/> <b>Nature of Charge</b>	<b>Floating Charge</b> (changes over time)	<b>Fixed Charge</b>	<b>Fixed Charge</b>

### **Understanding Charge Possession**

**Pledge** → *Ownership remains with the borrower, but possession is with the bank.*

**Hypothecation** → *Both possession & ownership remain with the borrower.*

#### **Example of Hypothecation:**

- **Car Loan**  → The borrower **uses the car** but cannot sell it without repaying the bank.

#### **Example of Pledge:**

- **Gold Loan** ☐ → The bank **keeps the gold** as security until the loan is repaid.

☐ **Example of Mortgage:**

- **Home Loan** ☐ → The borrower **lives in the house**, but the bank has a **charge over it** until the loan is cleared.
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LEARNING SESSIONS

## ✓ Summary Table - Charge Over Securities

<input type="checkbox"/> Type of Charge	<input type="checkbox"/> Asset Type	<input type="checkbox"/> Possession	<input type="checkbox"/> Legal Act	<input type="checkbox"/> Bank's Right to Sell
<input type="checkbox"/> Mortgage	Immovable Property	Borrower	Transfer of Property Act	Yes, through legal process
<input type="checkbox"/> Pledge	Movable Assets	Bank	Indian Contract Act	Yes, after notice
<input type="checkbox"/> Hypothecation	Movable Assets	Borrower	SARFAESI Act	Can convert into pledge
<input type="checkbox"/> Lien	Assets in possession of Bank	Bank	Contract Act	Can sell if lien is exercised
<input type="checkbox"/> Assignment	Actionable Claims	Bank (transfers rights)	Negotiable Instruments Act	Bank gets rights over proceeds