

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. ✅

👉 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.

[Primary Security]
Housing loan

Ⓐ → mortgage

✓ **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.

Owner of assets

🔧 Checklist for Executing Loan Documents

#imp

◆ (a) Stamping of Documents ✓

- ✓ Documents should be **properly stamped** to ensure legal validity.
- ✓ **Incorrect stamping** can lead to the document being unenforceable in court.

14th Feb → 14 or later

#imp

◆ (b) Execution Date 📅 #2

- ✓ The execution date should never be earlier than the stamping date.

→ Limitation

- ✓ Date & place of execution must be clearly mentioned.

◆ (c) Authority & Capacity to Sign → Jurisdiction

- ✓ 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

Aspect 📝	Key Points ✅
#1 Who Signs the Documents? 🖋️	<u>Borrowers & Guarantors</u>
#2 Primary Security Documents 🏠	Signed by Borrower
#3 <u>Collateral Security</u> 🏠	Signed by <u>Owner</u> (who must be a Guarantor)
#4 <u>Stamping of Documents</u> 📄	Must be Properly Stamped
#5 Execution Date 📅	Must not be earlier than Stamping Date
#6 Authority to Sign 👤	Person must have legal capacity

Charge Creation → Within 30 days

30 + 30 + 6 = 120

#7

Free Will 🤝

No coercion in signing

#8

Filling Before Signing 📝

No blank spaces allowed

ROC Registration 🏢

Charge must be registered within **30 days** 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?**

1 **For Individuals or Businesses with Higher Credit Risk**

2 **For Closely-Held Companies** (Where a few individuals or families

hold a majority of shares)

3 When the Financial Condition of the Borrower is Weak

4 If the Loan is Unsecured

5 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

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.

ABC

D₁

D₂

D₃

Remuneration

★ Summary Table - Third-Party Guarantees in Banking

📌 Condition	🔍 Requirement of Third-Party Guarantee
#1 Closely-Held Companies 🏢	✅ Personal guarantee of principal shareholders/directors
#2 Public Limited Companies (Unsecured Loan) 📈	✅ Directors' guarantees may be required
#3 Weak Financial Position 📉	✅ Guarantee required even if the loan is secured
#4 Delayed Charge Creation on Assets 🏠	✅ Temporary guarantee until charge is created
#5 Subsidiary with Poor Finances 🏭	✅ Parent company guarantee required
#6 Interlinked Finances with Other Companies 🔗	✅ Guarantee required
#7 Change in Management 👥	✅ Undertaking required to avoid sudden changes
Guarantee Commission 💰	❌ 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:

Primary security

- 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.

[Pledge]

Types of Charges in Banking

◆ Type of Charge	 Type of Security	 Example of Security
 Mortgage	Immovable Property <i>mortgagor - mortgagee</i>	Land, Building, Machinery <u>embedded to the earth</u> <i>[12 years]</i>
 Pledge	Movable Assets <u>Gold</u>	Raw Materials, Shares, Stocks, Gold, Jewellery <i>No limitation</i>
 Hypothecation	Movable Assets	Raw Materials, Motor Vehicles, Standing Crops <i>[3 years]</i>
 Lien	<u>Securities already in possession of the lender</u>	Goods and Securities (except actionable claims & money)

#1

#2











#3


#4

#5


 Assignment	<u>Actionable Claims</u>	LIC Policies, Book Debts, Receivables
-----------------------------------------------------------------------------------------------------	--------------------------	------------------------------------------


VS Comparison of Mortgage, Hypothecation, and Pledge

 Feature	 Hypothecation	 Pledge	 Mortgage
 Meaning	<u>Extended concept of pledge; a charge is created while possession remains with borrower.</u> <u>implied pledge</u>	<u>Bailment of goods as security for a loan.</u>	Transfer of interest in immovable property for securing a debt.
 Legal Status	Defined in Sec 2(n) of SARFAESI Act.	<u>Indian Contract Act (Sec 172).</u>	<u>Transfer of Property Act (Sec 58).</u>
 Applicable To	<u>Movable Goods</u>	<u>Movable Goods</u>	Immovable Property
 Types of Assets Covered	<u>Stocks, Vehicles, Machinery, Crops</u>	<u>Shares, NSC, KVP, Gold, Materials</u>	Land & Building, Machinery fixed to the earth
 Possession of Asset	<u>With Borrower</u>	With Bank <u>lender</u>	<u>With Borrower</u>
 Rights of Bank to Sell	<u>Can convert into pledge if borrower defaults.</u>	<u>Can sell after issuing a notice.</u>	<u>Can sell after legal process.</u>

 Nature of Charge	Floating Charge (changes over time)	Fixed Charge	Fixed Charge
----------------------------------------------------------------------------------------------------	--------------------------------------------	---------------------	---------------------

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.

Chapter 21 2nd part

8360944207

Carib Guru

✓ Summary Table - Charge Over Securities

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

◆ Possession of Security ◆ Part II

🔑 Possession & Risk Management

At the time of loan appraisal, **bankers** must decide **who will hold possession of the security**—the **bank** or the **borrower**. The legal system plays a role in this decision as possession affects the **risk rating** of the loan.

Symbolic possession

Type of Charge	Possession Held By	Example
Pledge	✓ Bank (Physical possession)	<u>Gold Loan, Share Certificates</u>
Hypothecation	✓ Borrower (Bank has legal rights over assets)	Car Loans, Inventory Loans
Mortgage	✓ <u>Borrower</u> (Bank holds a legal claim)	Home Loans, Land Mortgage
Lien	✓ Bank (Bank has a right over security)	Fixed Deposits, Government Bonds
Assignment	✓ Bank (Ownership rights assigned to lender)	LIC Policies, Receivables

📌 Traditional 'Lock & Key' Advances 🏠🔑

◆ Earlier, banks used the **'Lock & Key'** method where goods were stored in a **bank-controlled godown**.

◆ The **bank had the keys**, and the borrower could access goods only after paying for them.

◆ This system was **secure but inconvenient** for both banks and borrowers.

Transition to Hypothecation

◆ Over time, banks shifted to '**Hypothecation**', where borrowers retain **physical possession** of goods.

◆ The **bank retains the legal right** to seize and sell the asset in case of default.

Constructive Possession in Pledge

◆ In some cases, even under **Pledge**, a borrower may retain **possession** but act as an **agent of the bank**.

◆ Example: **Pledging warehouse stock**, where the borrower holds the goods but cannot sell without the bank's permission.

Conclusion

✓ The type of **charge over securities** depends on the nature of the asset, convenience, and risk management.

✓ While **Pledge & Lien** give **direct control** to banks, **Hypothecation & Mortgage** allow borrowers to retain **possession** but provide **legal control** to the lender.

cost

CC limit

Hyp.

implied pledge

possession → Lender


Symbolic pledge →







constructive pledge →

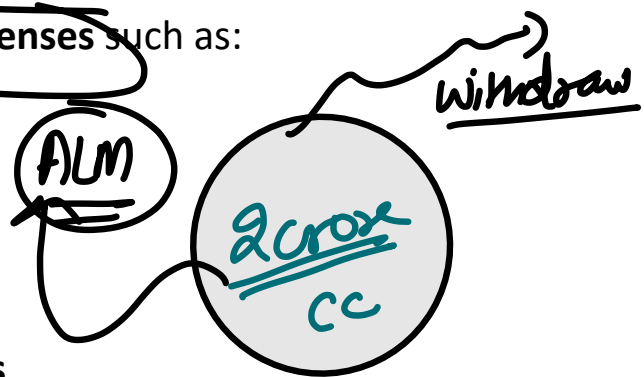
✓ The shift from 'Lock & Key' advances to **Hypothecation** has improved borrower convenience but requires **strong monitoring mechanisms**.

Disbursal of Loans - Working Capital Loans

What is a Working Capital Loan? 🤔














A **working capital loan** is a **credit facility** that helps businesses  manage **short-term operational expenses** such as:

- ✓   Raw Material Purchases
- ✓   Salaries & Wages
- ✓   Rent & Utilities
- ✓   Day-to-Day Business Expenses









Key Features of Working Capital Loans

3 Years







 Type of Loan	 Cash Credit (CC)	 Loan Component (WCL)
Flexibility 	Can be withdrawn & deposited anytime  	<u>Fixed amount disbursed at once</u> 
Interest 	<u>Charged only on the utilized amount</u> 	<u>Charged on the entire loan</u> 
Repayment 	No fixed repayment schedule 	Paid as <u>EMI/Bullet Repayment</u> 

↑ repayable on demand

Upto
3 years




Utilization 	Used for short-term needs 	Used for long-term working capital stability 
Real-life Example 	Retailers & Traders 	Manufacturing Firms 

Cash Credit (CC) Account

- ✓ The borrower **must route all transactions**  through the Cash Credit (CC) Account .
- ✓ No other current account  can be opened **without bank approval** .
- ✓ If the borrower **requires another account**, the bank **monitors**  the transactions via **statements** .

Real-Life Example: Tata Steel Ltd.

Tata Steel secures a ₹500 crore working capital limit .

- ✓ All purchases must be made via the designated CC account .
- ✓ Tata Steel cannot open another current account without prior permission  .

Understanding Drawing Power (DP)

 DP (Drawing Power) = The maximum borrowing limit  based on:




 Stock Value 

 **Receivables (Debtors)** 

 **Sundry Creditors (Payables)** 

 **Formula:**


$$DP = (\text{Stock Value} + \text{Receivables}) - (\text{Creditors} + \text{Margin})$$

 **DP is updated monthly**  **but can be reviewed more frequently in special cases** .


  **Real-Life Example: Maruti Suzuki** 





Maruti Suzuki secures a **₹200 crore working capital limit for inventory**



✓ **If stock levels drop, the bank reduces the DP, restricting how much can be borrowed** .

  **Why is Loan Disbursal Split?** 

 **Problem:**

- Borrowers **use full limits** when **interest rates**  **are high** .
- They **reduce utilization** when **liquidity is abundant** , leading to losses for banks .

💡 **Solution:** RBI mandates that banks **split working capital limits** into:

- ◆ **Fixed Loan Component** 🎯 – Mandatory disbursal 📁 WCL
- ◆ **Cash Credit Component** 🏠 – Flexible usage 📊 CC

💡 📌 **Example: Hindustan Unilever (HUL)** 🏭

HUL secures a ₹150 crore working capital limit.

- ✓ ₹90 crore is a fixed loan 🎯 (HUL must pay interest on this amount).
- ✓ ₹60 crore is a flexible cash credit limit 🏠 (HUL can draw as per need).

📌 🔔 RBI Guidelines on Loan & Cash Credit Components 🏠 📁

📄 Criteria	💰 Loan Component (%)	🏠 CC (%)
Borrowers with WC limits ≥ ₹150 Crores	<u>60% or more</u> 🎯	40% or less 📈
Export Credit Limits ✈️ 📦	Excluded ❌	-
Investment in Commercial Papers (CPs) 🏠	Part of Loan Component 📄	-




#1




Additional RBI Directives

(a) **Loan Component Bifurcation**



✓ **Export Credit** (pre-shipment/ post-shipment) **must be excluded** from the working capital limit  .

✓ **Commercial Papers (CPs)**  issued by the borrower are included in the loan component if sanctioned under WC limits  .

Real-Life Example: Reliance Industries Ltd.

Reliance has a **₹500 crore working capital limit**, but **₹200 crore is for exports** .

✓ The remaining **₹300 crore** is bifurcated into:

- **₹180 crore (60%) Loan Component** 
- **₹120 crore (40%) Cash Credit Limit** 

(b) **Loan Tenure & Splitting**

✓ **Minimum Loan Tenure: 7 days** 

✓ Banks can **split the loan component** into multiple maturities .

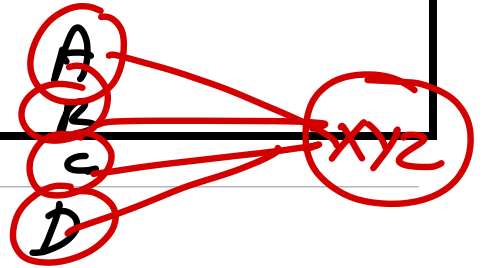
Example: Infosys Ltd.

Infosys secures a **₹50 crore working capital loan** and chooses to **split it** into:

Loan component

✓ ₹30 crore - 30-day maturity 📅 17

✓ ₹20 crore - 90-day maturity ⌚



Hint

(c) Loan Sharing in Consortium Banking 🏦🤝

- ✓ If multiple banks finance a borrower via **Consortium Banking**, they must ensure at least **60% of the WC limit is a fixed loan component** 🇮🇳.
- ✓ In **Multiple Banking Arrangements (MBAs)**, each bank **individually ensures compliance**.

💡 📌 Real-Life Example: JSW Steel 🏗️

JSW Steel secures ₹3,000 crore in WC from a consortium of SBI, ICICI, HDFC & Axis.

- ✓ ₹1,800 crore (60%) is loan 🎯
- ✓ ₹1,200 crore (40%) is cash credit limit 🏠

(d) Repayment & Rollover 🔄💰

✓ Repayment Options:

- Installments 💰 OR
- Bullet Repayment 🎯 (one-time full payment)

✓ Loan can be rolled over on borrower's request 🔄 but must follow RBI norms 📜.

💡 📌 **Example: Larsen & Toubro (L&T)** 🏗️

L&T secures a ₹500 crore WC loan and chooses bullet repayment after 180 days instead of monthly EMIs.

📢 Why is This Important? 🎯

- ✓ ✅ **Ensures Stability** 📊 – Prevents fluctuations in loan utilization 📈.
- ✓ ✅ **Prevents Fund Diversion** 🚫 📄 – Stops borrowers from misusing funds 🚫.
- ✓ ✅ **Enhances Credit Discipline** 📅 – Encourages structured repayments 💰.
- ✓ ✅ **Reduces Bank's Liquidity Risks** 🏦 – Helps banks plan funds efficiently 💰 📊.

◆ By following these RBI guidelines, banks ensure that working capital loans are efficiently disbursed, utilized, and managed! 🎯 📊 🏦

CH-21 module C Part-III

📅 **Term Loans - Disbursement & RBI Guidelines** 🏦 💰

🟢 **What is a Term Loan?** 🤔

A **Term Loan** is a **fixed sum of money** 💰 borrowed for a **specific purpose** with a **fixed repayment schedule** 📅. It is typically used for **capital expenditures** like:



10 lac →

- ✓ Machinery Purchase
- ✓ Real Estate/Building
- Expansion of Business
- ✓ Infrastructure Development
- ✓ Personal or Consumption Needs

Key Features of Term Loans


Criteria	Business Term Loan	Personal/Consumer Loan
Purpose <i>Capex</i>	Machinery, Equipment, Expansion, Infrastructure	House Purchase, Vehicle Loan, Education Loan
Loan Disbursement	<u>Direct to Supplier/Contractor</u>	Credited to Borrower's Account
Equity Contribution (Margin)	Mandatory from Borrower	May Not Always be Required
Repayment	<u>Fixed EMIs/Structured Payments</u>	Fixed EMIs
Example	Tata Motors financing new EV manufacturing plant	Amit takes a home loan for ₹50L

Loan Disbursement Process


💡  Term Loans may be disbursed in **one go** or in multiple installments  depending on the type of purchase.


1 Single-Stage Disbursement (One-Time Payment)

✓ Used for machinery purchases , ready houses , and equipment .

✓ Borrower **deposits margin money**  before the bank releases funds.

✓ Loan amount **credited to seller's account directly** .

✓ If the borrower has **already made a payment**, proof (bank statement, invoice) is required .


✓ In special cases (personal loans, consumer loans), **loan may be credited directly** to the borrower's account .

💡 Real-Life Example: Infosys Ltd.

Infosys secures a **₹100 crore** loan to purchase servers & IT equipment .

20 cr + **80 cr**

✓ Infosys **pays 20% margin upfront** .

✓ The bank **directly transfers the remaining ₹80 crore** to the **supplier's account** .

2 Multiple-Stage Disbursement (Project-Based Loan)

- ✓ Used for infrastructure projects 🏗️, factory setup 🏭, and real estate development 🏢.
- ✓ Disbursal **linked to project milestones** 📅.
- ✓ Ensures **funds are not misused** 🛑.
- ✓ **Reduces risk for banks** 🏦.

₹100 crores

💡 Real-Life Example: Delhi Metro 🚇

DMRC secures a **₹500 crore loan for Phase-4 expansion**.

- ✓ ₹100 crore released for land acquisition 🏗️.
- ✓ ₹150 crore released for track laying 🚆.
- ✓ ₹250 crore released after project completion ✅.

📄 RBI Guidelines on Project Loan Disbursement 📄

🏦 Banks generally follow **one of three methods** for promoter equity contribution:

1 Full Upfront Contribution ✅

lowest Risk

- ✓ Promoters bring 100% of their equity before loan disbursal.
- ✓ **Lowest risk for banks** 🏦.
- ✓ Ensures **higher financial commitment** from promoters.

💡 📍 Real-Life Example: Reliance Jio 📡

Reliance Jio secured a ₹50,000 crore loan for 5G rollout.

- ✓ Mukesh Ambani invested ₹10,000 crore upfront before the bank disbursed the loan.

2 Partial Upfront Contribution (40-50%) 💰

- ✓ Promoters bring 40-50% equity initially 💰.
- ✓ Remaining equity infused in stages 📅.
- ✓ Moderate risk for banks 🏦.

💡 📍 Real-Life Example: Adani Ports 🚢

Adani Ports secures a ₹1,000 crore project loan for new terminals.

- ✓ Adani brings ₹400 crore equity upfront before loan disbursement.
- ✓ Remaining ₹600 crore equity infused in stages.

3 Proportionate Equity Infusion 🔄 (High-Risk) 🚨

- ✓ Promoters bring equity as banks disburse debt.
- ✓ Higher risk for banks 🏦 because promoters may delay equity contribution.
- ✓ Banks must monitor Debt-Equity Ratio (DER) 📊.

I → 100% contribution (Lowest Risk)
II → 40-50% (Moderate)
III → proportionate (Highest)

💡 📍 Real-Life Example: Kingfisher Airlines ✈️

Kingfisher Airlines secured a ₹2,000 crore loan but delayed equity contribution 📄.

🚫 Banks suffered huge NPAs when the company defaulted.

📌 🔍 Why Do Banks Need Debt-Equity Ratio (DER)

Monitoring? → Leverage Financial

📌 $DER = \frac{\text{Total Debt}}{\text{Total Equity}}$ 📊

$\frac{LTL}{TNW}$

- ✓ Ensures promoters maintain financial discipline.
- ✓ Prevents excessive leverage and risk exposure 🚫.
- ✓ RBI mandates banks to clearly define DER policies 📄.

💡 📍 Real-Life Example: HDFC Bank 🏦





















- ✓ Maintains a DER policy of max 2:1 for corporate loans.
- ✓ Ensures borrowers contribute equity before drawing loans.

📣 Why is This Important? 🎯

- ✓ Prevents Loan Default 🚫 – Ensures borrower has financial commitment 📄.
- ✓ Reduces Risk for Banks 🏦 – Proper debt-equity management 📊.
- ✓ Prevents Fund Misuse 🚫 – Loans linked to project milestones 🏗️.

✓  Ensures Project Completion  – Banks release funds as per execution progress  17.

  **Summary Table: Term Loans & Disbursement** 

Feature 	Single-Stage Disbursement 	Multiple-Stage Disbursement 
Best For 	Machinery, Ready House, Vehicles 	Infrastructure, Factories, Business Expansion 
Margin Requirement 	Full margin upfront 	Margin infused as per project milestone 
Funds Disbursed To 	Directly to Seller/Supplier 	Based on project progress 
Example 	Infosys IT Equipment 	Delhi Metro Expansion 
Risk to Banks 	Low Risk 	Higher Risk if not monitored properly 
RBI Recommendation 	Allowed but should ensure borrower contribution	Banks should monitor Debt-Equity Ratio (DER) 

Important

Lending Under Consortium & Multiple Banking

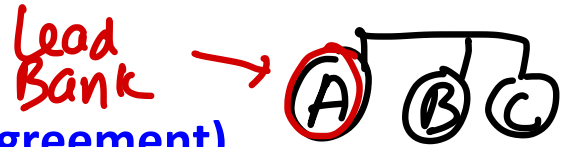
Arrangements 🏦🤝



📌 What is Lending Under Consortium & Multiple Banking? 🤔

💰 When a business needs a large amount of financing that **exceeds the risk appetite of a single bank**, it may seek funding from multiple banks.

This can happen in **two major ways**:



1 Consortium Lending 🤝 (Formal Agreement)

✓ A **formal arrangement** where **two or more banks** jointly finance the working capital needs of a borrower.

✓ One bank is chosen as the **Lead Bank 🎯** which **coordinates, assesses, monitors, and manages the credit facility.**

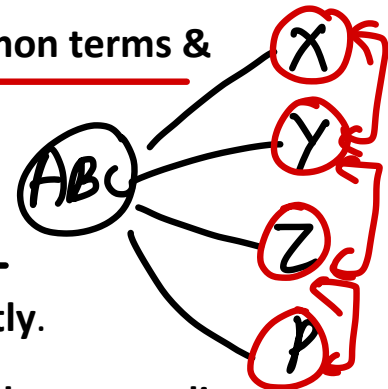
✓ Banks work together, share information, and set common terms & conditions 📄.

#2 2 Multiple Banking 🏦 (No Formal Agreement)

✓ Borrower takes loans from **multiple banks independently.**

✓ No formal agreement between banks, but they **may exchange credit information 📊.**

✓ Higher risk of **fraud 🛑** if information is not shared effectively.



📌 Real-Life Examples 📌

💡 **Consortium Lending Example:** Reliance Industries took a ₹40,000 crore loan for refinery expansion. SBI acted as Lead Bank with other banks like ICICI, HDFC, and Axis financing different portions of the loan. *asset monitor*





💡 **Multiple Banking Example:** Kingfisher Airlines availed loans from multiple banks **without a formal consortium**. Due to lack of information sharing, the airline **defaulted**, leading to a massive banking fraud. 🚨

📖 RBI Guidelines on Consortium & Multiple Banking 🏦

◆ To prevent fraud and improve transparency, RBI issued **key regulations** for banks financing borrowers under multiple banking arrangements.

📌 RBI Guidelines	📌 Key Requirements
#1 📄 Declaration from Borrowers	At the time of granting new loans, banks must obtain a declaration from borrowers about existing credit facilities from other banks.
#2 📊 Quarterly Information Sharing <i>(QIS)</i>	Banks must exchange information every quarter on borrower's account conduct, derivative transactions, and foreign currency exposure.

#3








 Professional Certification	Borrowers must provide regular compliance certification by a Company Secretary, Chartered Accountant, or Cost Accountant .
 Credit Reports & Due Diligence	Banks should use credit reports from Credit Information Companies (e.g., CIBIL, Equifax, Experian, CRIF Highmark).
 Confidentiality Clause in Loan Agreements	Loan agreements must include clauses allowing banks to share credit information .
 Timely Decision-Making	Banks should ensure quick appraisals & decision-making in consortium lending.

#4

Imp

📌 🇮🇮 Key Differences Between Consortium & Multiple Banking

Arrangements

Feature 	Consortium Lending 	Multiple Banking 
#1 Definition 	Formal agreement among multiple banks to finance a single borrower.	Borrower avails loans independently from multiple banks.
#2 <u>Lead Bank</u> 	One bank is designated as the Lead Bank .	No lead bank; each bank deals separately with the borrower.
#3 Risk Management 	Lower risk as banks share information .	Higher risk of fraud & fund diversion  .

#4

Credit Monitoring 🏦	Joint monitoring & periodic meetings for assessment 📊	<u>Banks monitor separately,</u> <u>increasing risk of non-disclosure.</u>
Example 📍	Tata Steel takes a ₹25,000 crore loan, led by SBI in a consortium with ICICI, HDFC, and Axis Bank.	Vijay Mallya took loans from multiple banks independently , leading to Kingfisher Airlines' default & fraud case.

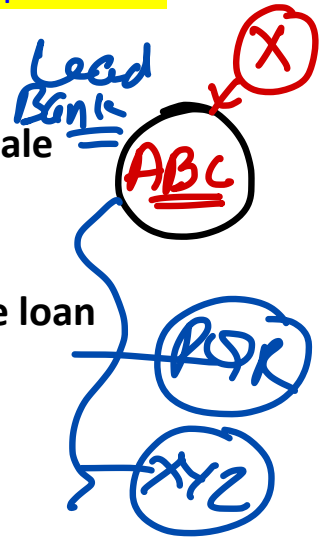
Loan Syndication 🏦

Important

✓ **Loan Syndication = Sharing a large-term loan among multiple banks for a single borrower.**

✓ Helps banks **spread risk** 🔄 & provide financing to large-scale projects 🚧.

✓ Borrower mandates a **Lead Bank** to arrange and negotiate loan terms with other banks.



How Loan Syndication Works? 🤝

#1 **1 Borrower Approaches Lead Bank** 🎯 – The borrower gives a **mandate to a lead bank** to raise the required loan amount.

#2 **2 Lead Bank Finds Other Lenders** – The lead bank approaches **other banks** to share the loan.

#3 **3 Appraisal & Approval** ✅ – Each bank **assesses the risk & financial viability** of the project before sanctioning the loan.

#4

4 **Common Terms & Conditions** 📄 – Participating banks agree on loan tenure, interest rates, repayment schedule, and security.

#5


5 **Loan Disbursement** 💰 – Funds are disbursed as per **project needs & milestones.**









💡 📍 **Real-Life Example: Mumbai Metro** 🚇

- ✓ SBI led a ₹5,000 crore syndicated loan for Mumbai Metro's expansion.
- ✓ Other banks like HDFC, ICICI, and PNB participated.
- ✓ The loan was disbursed in phases linked to project completion.

📌 📊 **Key Differences Between Consortium & Loan Syndication**

Feature	Consortium Lending 🤝	Loan Syndication 🏦
Definition	Multiple banks finance <u>working capital needs.</u>	Multiple banks finance a <u>long-term loan/project.</u>
Lead Bank 🎯	Coordinates assessment & monitoring.	Acts as an <u>arranger</u> but doesn't necessarily finance the loan.
Loan Type 💰	<u>Working capital loans.</u>	<u>Long-term loans</u> for large projects.
Risk Sharing 🔄	Risk is shared <u>equally among all banks.</u>	Risk is <u>distributed based on participation levels.</u>

Example 	Reliance Industries secured a working capital loan via a banking consortium.	Mumbai Metro raised funds through a syndicated loan from SBI, ICICI & HDFC.
-----------------------------------------------------------------------------------------------------	------------------------------------------------------------------------------	-----------------------------------------------------------------------------

Feature 	Consortium Lending 	Multiple Banking 	Loan Syndication 
Definition 	Formal arrangement among banks to finance a borrower.	Borrower avails loans from multiple banks independently.	Sharing of a <u>large-term loan among banks.</u>
Lead Bank 	Yes, Lead Bank coordinates assessment & monitoring.	✗ No Lead Bank.	Yes, Lead Bank arranges & negotiates terms.
Loan Type 	<u>Working Capital Loans.</u>	Varied Loans (Working Capital, Term Loans).	Project-Based Long-Term Loans.
Risk Management 	Risk shared among banks.	Higher risk if information is not shared.	Risk distributed based on participation levels.

Information should

may or may not be shared

shared

Arranges

RBI Guidelines 📄	Banks must exchange information quarterly.	Banks must verify <u>credit history</u> before <u>granting loans.</u>	Banks assess <u>project feasibility</u> <u>before syndicating the loan.</u>
Example 📍	Tata Steel's ₹25,000 crore working capital loan.	Kingfisher Airlines' fraud due to lack of coordination.	Mumbai Metro's ₹5,000 crore syndicated loan.

📣 Why Does This Matter? 🎯

- ✓ **Prevents Loan Default** 🚫 – Ensures proper risk sharing & monitoring.
- ✓ **Reduces Risk for Banks** 🏦 – Proper due diligence & information exchange.
- ✓ **Prevents Fund Misuse** 🚫 – Protects against financial fraud & loan diversion.
- ✓ **Ensures Smooth Lending** 🏗️ – Enables large corporations & infrastructure projects to access capital.

Part 4 CH-21 Module C ABM

📖 Straight-Through Loan Processing (STP) & Credit Underwriting Engines (CUE) 🚀🏦







📌 What is Straight-Through Loan Processing (STP)? 🤖💰

◆ STP refers to the full automation of the loan approval process from application to disbursement, with minimal or no human intervention.

◆ It allows banks & financial institutions to process more loans in less time, freeing up resources for complex cases.






















◆ Initially used for personal loans 🏠🚗, STP is now applied in MSME & commercial lending as well.

📖 Evolution of Loan Processing in Banking ⌚🏦

 Time Period	 Key Development
1980s 	Shift from manual to mechanized loan processing.
1990s 	New Generation Private Banks emerged, introducing digital banking & centralized loan processing.
2000s 	Online banking, Internet & mobile banking paved the way for automated lending.
Present 	Straight-Through Processing (STP) enables full automation with AI & ML.



How Does STP Work?

Traditional Loan Processing vs. STP

Step	Traditional Process (Manual) 	STP (Automated) 
Loan Application 	Paper-based form submission 	Online/Digital application 
Document Verification  	Manual verification 	Automated validation using AI & database checks 
Credit Assessment 	Done manually by bankers 	AI-driven risk assessment with real-time credit bureau data 
Loan Decision 	Subject to human bias & delays 	Fully automated, quick decisions 
Approval & Disbursement 	Multiple approvals required 	Instant loan approval & fund transfer 
Overall Time Taken 	2-10 days 	Few minutes to hours 

Benefits of STP for Banks & Customers

For Banks

 **Faster Loan Processing**  – Reduces loan approval time from **days** to minutes.

 **Cost-Effective**  – Less dependency on manual labor reduces

operational costs.

✔ **Minimizes Errors & Frauds** 🔍🚫 – AI-driven validation ensures accuracy in **credit risk assessment**.

✔ **Scalability** 📈 – Enables banks to handle **higher loan volumes** efficiently.

◆ **For Customers** 👤

✔ **Faster Loan Approvals** ⚡ – No need for repeated visits to the bank.

✔ **Convenience** 📱 – Apply for loans **anytime, anywhere**.

✔ **Better Transparency** 🔍 – Customers get instant updates on **loan status**.

📌 🔍 **Real-Life Examples of STP in Banking**

💡 **Example 1: HDFC Bank Home Loans** 🏠

✔ HDFC uses **AI-based loan approval** ✔

✔ **E-KYC, Aadhaar & PAN validation linked to STP** 🔄

✔ **Instant approval & disbursement in 48 hours** ⌚



💡 **Example 2: SBI YONO Personal Loans** 📱

✔ **Fully digital pre-approved personal loans** ⚡

✔ **Minimal documentation & instant processing** 📄

✔ **Funds credited within a few minutes** 💰



💡 **Example 3: Paytm & Bajaj Finance EMI Loans**

- ✓ Customers get **instant credit approvals** for online purchases 
- ✓ AI-powered **risk assessment & fraud detection** 




Credit Underwriting Engines (CUE)

◆ **Credit Underwriting Engine (CUE) is an AI-powered risk assessment system used in STP.**

◆ It **analyzes loan applications** based on multiple parameters like:

- ✓ **CIBIL Score & Credit History** 
- ✓ **Income-to-EMI Ratio (Debt-to-Income Ratio)** 
- ✓ **Loan-to-Value Ratio (LTV)**  
- ✓ **Employment Stability & Industry Risk**  












Role of CUE in Loan Decision-Making

- ✓ Reduces **manual errors & fraud risk** 
- ✓ Ensures **objective & unbiased credit approval** 
- ✓ **Automates complex financial calculations** 













💡 **Example:**

- ◆ **Amazon Pay Later uses CUE & AI algorithms to approve "Buy Now, Pay Later" loans instantly!**  

Risks & Challenges in STP Implementation

 Challenge	 Issue	 Solution
 Data Security & Privacy	Risk of data breaches & hacking 	Use secure encryption & compliance with data protection laws.
 Documentation Errors	Incorrect data entry leads to rejection 	AI-based document validation & OCR scanning.
 Over-Reliance on Automation	Complex cases may need human judgment 	Hybrid model: Automated + Manual review for special cases.
 Compliance with RBI Regulations	Regulatory changes may impact STP processes 	Regular software updates & compliance checks.

Summary Table: STP vs. Traditional Loan Processing

Feature 	Traditional Loan Processing 	Straight-Through Processing (STP) 
Speed 	2-10 days 	Few minutes to hours 
Human Intervention 	High, prone to bias & delays	Minimal, AI-driven decisions 
Documentation 	Manual, Paper-based	Digital, AI-verified 
Risk Assessment 	Done by credit officers	Automated CUE-based risk analysis 


Error Rate 🔍	High due to manual handling	Low, AI minimizes errors ✅
Fraud Prevention 🛡️	Basic checks, prone to fraud	Advanced AI-powered fraud detection 🛑
Cost Efficiency 💰	High operational costs	Lower costs due to automation 📈
Loan Disbursement 🏠	Delayed	Instant disbursement 💰
Customer Experience 🤝	Slow, paperwork-heavy	Seamless, fast & hassle-free 🎯

📣 Why STP is the Future of Banking? 🌍💡

- ✓ **Faster Loan Processing** 🚀 – No need to wait for manual approvals!
- ✓ **Cost-Effective for Banks** 🏦 – Less paperwork, fewer staff hours required.
- ✓ **Fraud Detection & Compliance** 🛡️ – AI-powered **real-time validation** & fraud prevention.
- ✓ **Customer Convenience** 📱 – Loans anytime, anywhere, with minimal hassle!

💡 ✨ **Future Trend:**

- ◆ **AI & Machine Learning** 🤖 will further **enhance STP efficiency!**

◆ **Blockchain technology**  could be integrated for **secure lending transactions**.

Risk Mitigation & Machine Lending in STP


Credit Decision: The Endgame of Risk Mitigation


Before a lender **sanctions a loan**, all possible **risk factors** must be identified and mitigated.

A robust **STP (Straight-Through Processing) system** ensures **automated risk evaluation** with minimal human intervention.

◆ **Key Risks Considered in Credit Assessment**

✓ **Industry & Business Risks** – Market trends, sector performance 

✓ **Management Risks** – Experience, integrity, decision-making ability of promoters 

✓ **Financial Risks** – Revenue, profitability, debt obligations 

✓ **Legal Risks** – Pending litigations, regulatory compliance 

✓ **Default Risks** – Credit history, past repayment behavior 

✓ **Country Risks** – Economic & political stability 

✓ **Exchange Risks** – Forex fluctuations for international businesses 


Role of AI & Big Data in Risk Mitigation

- ◆ **STP Software** integrates with **third-party data providers** to analyze real-time borrower **transactions, financial health & repayment behavior**.
- ◆ **Artificial Intelligence (AI) & Machine Learning (ML)** predict default risks based on borrower's **economic behavior patterns**.

Example: How AI Mitigates Risk in Lending

- ✓ **Indian banks now scan & upload borrower account statements in joint lending.**
- ✓ **STP software detects & removes round-about transactions to eliminate fake turnover inflation.**
- ✓ **AI creates an adjusted Profit & Loss statement based on actual trade transactions, ensuring transparency.**
- ✓ **Final credit score is generated automatically, helping in accurate lending decisions.**

◆ **Case Study: Credit Information Companies (CICs) in India**

- ✓ Credit bureaus like **CIBIL, Experian & Equifax** aggregate borrower data 
- ✓ Banks **fetch real-time credit reports** for assessing repayment

behavior 

✓ **STP software** processes **past repayment trends** to predict **default probability** 


Machine Lending: AI-Driven Credit Decisioning

◆ **Human bias & manual errors** are eliminated through **pre-defined lending rules & AI-driven assessments**.

◆ Loan approvals are based on **quantitative & qualitative factors**, such as:

✓ Loan-to-Value Ratio (LTV) 

✓ Debt-to-Income Ratio (DTI) 

✓ Macroeconomic & Industry Trends 


✓ Borrower's **financial behavior & credit score** 

Key Advantages of Machine Lending

✓ **Faster Loan Approvals** – AI processes applications in **seconds** 

✓ **Error-Free Decisions** – No **human biases** or **manual mistakes** 

✓ **Dynamic Rule Engine** – AI **adapts to economic changes** 

✓ **Scalable Lending** – Banks can process **millions of applications** **simultaneously** 

💡 Example: How STP Works in Instant Digital Lending 📱

- ✓ Google Pay, Paytm, & Bajaj Finance use AI-driven lending models 📡
- ✓ AI fetches credit score & transaction history from banks 🏦
- ✓ Instant approval & loan disbursement in minutes ⌚

🚫 Preventing Omissions & Commissions in Lending 🚫

✗ Unintentional Omissions – Missing key details due to human errors



✗ Intentional Commissions (Fraud) 🚫 – Loan approval through false information & manipulation

💡 How STP Eliminates Errors? 🤖

✓ AI-Driven Data Validation – Cross-checks borrower's financial history 📄

✓ Credit Bureau Reports Integration – Fetches real-time loan repayment behavior 🔄

✓ Fraud Detection Algorithms – Detects fake documents & manipulated transactions 🛑



✓ Pattern Recognition – Identifies unusual transaction behaviors 🔍

 **Example:**





✓ Human banker might mark a **borrower's history** as "Satisfactory" without detailed analysis 🙋

✓ **AI-driven STP software** scans multiple financial sources & provides a **factual risk rating** 📊






 **Summary Table: AI-Based Risk Mitigation vs. Traditional Lending**

 Risk Factor	Traditional Lending 	AI-Powered STP Lending 🤖
Processing Time ⌚	3-7 days	Minutes ⌚ ⚡
Human Bias & Errors 🙋	✅ High	❌ None (AI-driven)
Fraud Detection 🛡️	Limited	Advanced AI checks 🔍
Scalability 📈	Manual & slow	Can handle millions of applications 📊
Risk Analysis 📊	Based on limited data	Big Data & Credit Bureau Integration
Loan Approval Accuracy ✅	75-80%	95-98%
Customer Satisfaction 🤝	Moderate	High – Instant Approvals ⚡

Why AI-Based Risk Mitigation is the Future?

- ✓ **Faster & More Accurate Lending Decisions** 
- ✓ **Real-time Credit Risk Analysis & Fraud Prevention** 
- ✓ **Better Loan Approvals for Low-Risk Borrowers** 
- ✓ **Scalable & Cost-Effective for Banks** 

Future Trends in Machine Lending

-  **Blockchain-based Loan Verification** 
-  **AI-powered Predictive Default Analysis** 
-  **Real-Time Credit Scoring & Personalized Loan Offers** 