CREDIT POLICY

What is a Credit Policy?

Definition:

The **Credit Policy (Loan Policy)** of a bank is a **structured guideline** that directs how a bank **grants, manages, and monitors loans & advances**.

Purpose:

- Ensures **efficient lending** while **minimizing risks**
- Balances **credit volume, earnings & asset quality**
- Aligns lending with **regulatory requirements** & **corporate goals**
- Maintains **customer satisfaction & profitability**

Example:

- A **bank's Credit Policy sets rules** that ensure **loans are given only to customers with verified income & good credit history**.

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☐ 1. Key Components of a Bank's Credit Policy

Component	Purpose	Example
☐ **Customer Acceptance Policy**	Defines **who can apply for loans** & eligibility criteria	A bank **only lends to customers with a stable income & good credit history** ✓
☐ **Know Your Customer (KYC) Policy**	Ensures **identity verification to prevent fraud & money laundering**	A customer **submits PAN, Aadhaar & bank statements before loan approval** ☐
☐ **Retail & Corporate Lending Guidelines**	Establishes rules for **home, business, & corporate loans**	A **home loan requires a minimum CIBIL score of 750** ✓
☐ **Customer Due Diligence**	Evaluates **customer's repayment ability & creditworthiness**	A bank **analyzes financial documents**

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		before granting a ₹10 lakh loan

⬚**Example:**

A **bank cannot give a ₹50 lakh business loan** to a customer **without checking financial documents, business stability & repayment capacity**.

⬚ **2. Why Do Banks Need a Credit Policy?**

✓ **Regulatory Compliance:** Ensures the bank follows **RBI guidelines & risk management rules** ⬚

✓**Risk Management:** Reduces chances of **loan defaults & bad debts** ⬚

✓**Loan Portfolio Quality:** Ensures **balanced loan distribution** across different sectors ⬚

✓**Consistent Decision-Making:** Avoids **biased or inconsistent loan approvals** ⬚

✓**Customer & Shareholder Trust:** Builds **confidence in the bank's financial stability** ⬚

 Example:

- A **bank cannot lend 80% of its funds to real estate alone**. Instead, **it must diversify across agriculture, business, personal loans, etc.**

 3. Credit Function – What Does It Cover?

 Types of Loans & Advances in a Bank's Credit Portfolio:

Type of Loan	Purpose	Who Uses It?
Home Loan	Buying or constructing houses.	Salaried & business professionals.
Personal Loan	Unsecured loan for personal expenses.	Individuals for medical, travel, weddings, etc.
Business Loan	Funding company operations or expansion.	Small & large businesses.
Working Capital Loan	Short-term business financing.	Retailers, traders, MSMEs.

⬜ Term Loan	Long-term capital investment.	Factories, industries.
⬜ Overdraft Facility	Flexible borrowing for cash flow management.	Businesses with fluctuating income.
⬜ Letter of Credit (LC)	Facilitates international trade payments.	Importers & exporters.
✅ Bank Guarantee	Ensures financial security in business deals.	Contractors, businesses.

⬜ **Example:**

- A **textile company in Surat** applies for a **working capital loan of ₹1 crore**.
- The **bank checks financials & approves loan under business lending guidelines**. ✅

4. Credit Policy Objectives & Framework

✅1. Maintaining Loan Portfolio Quality 📊

- Ensure **loans are granted to creditworthy borrowers**.
- Monitor **loan repayments regularly**.

✅2. Balancing Profitability & Risk ⚖️

- Earn **interest from loans while minimizing defaults**.
- Diversify lending **across sectors to manage risk**.

✅3. Ensuring Liquidity 💧

- Avoid **excessive long-term lending** from **short-term deposits**.
- Maintain **liquid reserves to meet withdrawal demands**.

✅4. Regulatory Compliance 📜

- Follow **RBI norms & financial laws**.
- Implement **Anti-Money Laundering (AML) & KYC policies**.

Example:

A **bank follows strict due diligence** before granting a **₹5 crore corporate loan** to prevent **bad debts & frauds**.

⬜ Summary Table: Credit Policy & Lending Guidelines

Aspect	Details	Example
⬜ **Credit Policy Purpose**	**Balances risk, profitability & compliance**	Ensures **only creditworthy customers get loans** ✓
⬜ **Key Components**	Customer Acceptance, KYC, Due Diligence, Lending Rules	A **₹50 lakh business loan requires CIBIL & financial documents**
⬜ **Risk Management**	Diversification, monitoring, compliance	A **bank limits real estate loans to 15% of total portfolio**
⬜ **Loan Portfolio**	Includes home, business, personal, working capital loans	A **Delhi startup gets a ₹2 crore term loan for expansion**
⬜ **Objectives**	**Ensure liquidity, profitability & regulatory compliance**	**Bank follows RBI's lending limits & risk guidelines**

☐ Conclusion

A **well-structured Credit Policy** ensures that **banks lend responsibly, maintain a high-quality loan portfolio, and comply with regulatory norms** ✅ **By balancing risks, profitability, and liquidity**, banks **maximize growth & financial stability** ☐☐☐.

☐ Credit Policy Framework in Banks ☐☐

☐ 1. What is a Credit Policy Framework?

✅Definition

The **Credit Policy Framework** is a **formal document approved by a bank's Board** that **guides all lending activities** while ensuring **regulatory compliance & risk management**.

✅Purpose:

- Ensures **consistent credit decisions** across all branches ☐

- Defines **risk tolerance & exposure limits** ⬜

- Guides **loan approvals, deviations & responsibilities** ✓

- Ensures **compliance with RBI guidelines** ⬜

⬜**Example:**

A **bank's Credit Policy states that home loans cannot exceed 80% of property value**. If a loan officer **wants to sanction a 90% loan**, they must **get special approval from the Credit Risk Committee**.

⬜ **2. Key Components of a Credit Policy Framework**

Component	Purpose	Example
⬜ **Written Credit Policy**	A formal document defining lending rules & risk limits.	A bank's policy states that **personal loans above ₹10 lakh require additional approval**. ✓
⬜ **Risk Tolerance &**	Defines maximum loan amount for	No **single borrower can get more than**

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Exposure Limits	borrowers & industries.	15% of the bank's capital. ✓
⊠ Handling Loan Deviations	Defines procedure for approving exceptions in lending rules.	A loan officer **must seek approval for loans exceeding exposure limits**. ✓
⊠ Credit Risk Committee (CRC)	Approves new loan products & high-risk proposals.	A bank **launching a new startup loan must get CRC approval**. ✓
⊠ Credit Function Organization	Defines roles & responsibilities in lending departments.	A **branch manager can approve up to ₹5 crore loans, higher amounts need HQ approval**. ✓

⊠ 3. Role of RBI in Credit Policy Framework ⊠

⊠ **As per RBI Guidelines on Risk Management Systems**, each bank   must:

✓**Set up a Credit Policy Committee (CPC)** to oversee credit risk

management.

☑ **Define policies on loan approvals, risk limits & asset concentration**.

☑**Ensure compliance with RBI lending norms & prudential limits**.

☒**Example:**

RBI **mandates banks to limit large credit exposures** to a **single borrower or group of borrowers**. The **CPC ensures compliance** by setting **exposure limits**.

☒ **Who is part of the Credit Policy Committee?**

Position	Responsibility
☒ **Chairman / CEO**	Heads the committee & ensures strategic alignment.
☒ **Credit Department Head**	Oversees loan approvals & compliance.
☒ **Treasury Head**	Manages credit & liquidity risks.
☒ **Credit Risk Management Head**	Ensures risk assessment & portfolio monitoring.

⬜ **Chief Economist**	Analyzes market trends & economic risks.

⬜**Example:**

If a **bank wants to increase exposure to the real estate sector**, the **CPC evaluates market risks & approves changes in lending limits**.

⬜ **4. Credit Risk Management Department (CRMD) – Role & Responsibilities**

✅ **Independent department from Credit Administration** ⬜

✅**Monitors compliance with risk parameters & exposure limits** ⬜

✅**Lays down risk assessment systems & ensures loan portfolio quality**

✅**Conducts periodic loan audits & MIS reporting** ⬜

⬜**Example:**

A bank's **CRMD identifies rising defaults in MSME loans**. It **recommends stricter eligibility criteria & better risk monitoring**. ✅

⬚ Key Functions of the CRMD

Function	Purpose
⬚ Risk Assessment	Evaluates credit risk before approving loans.
⬚ Loan Portfolio Monitoring	Tracks overall loan performance & NPAs.
⬚ Problem Identification & Correction	Detects bad loans & suggests corrective actions.
⬚ Compliance & Reporting	Ensures adherence to RBI regulations.

⬚ 5. Summary Table: Credit Policy Framework in Banks

Aspect	Details	Example
⬚ Credit Policy Framework	Guides lending decisions & risk tolerance.	A bank's policy states that **business loans above ₹50 crore need HQ approval**.

▢ **Credit Policy Committee (CPC)**	Oversees credit policy, risk limits & compliance.	If a **bank wants to increase home loan exposure, CPC must approve**.
▢ **Credit Risk Management Department (CRMD)**	Monitors risk, enforces policy & ensures portfolio quality.	If **default rates rise, CRMD suggests corrective actions**.
▢ **Handling Deviations**	Defines approval process for lending exceptions.	A **loan officer cannot approve a high-risk loan without special approval**.
▢ **Periodic Updates & Adaptation**	Policy must evolve with market & regulatory changes.	A bank **updates loan policies based on RBI directives & economic trends**.

▢ **Conclusion**

A **well-structured Credit Policy Framework** ensures that banks **lend responsibly while managing risks & complying with RBI norms** ✓ By **setting clear lending guidelines, monitoring risk exposure, and updating policies periodically**, banks can **maintain financial stability & profitability** ▢▢▢.

🏢 **Contents of a Credit Policy in Banks** 📄💰

✳ **1. What is a Credit Policy Document?**

✓**Definition:**

A **Credit Policy Document** is a **formal written guideline** that defines how a **bank grants, manages, and monitors credit** while ensuring **risk management & regulatory compliance**.

✓**Purpose:**

- Sets **clear lending rules & approval processes** ▢
- Ensures **risk control & compliance with RBI guidelines** ✓
- Defines **loan types, approval authorities, & portfolio composition** ▢

- Helps in **decision-making & consistency across bank branches** ⬜

⬜**Example:**

A **bank's Credit Policy states that unsecured personal loans above ₹10 lakh require additional approval** from the Credit Risk Committee. ✅

⬜ **2. Key Contents of a Bank's Credit Policy**

Section	Purpose	Example
⬜ **Purpose & Contents**	Outlines the **goals & framework** of the policy.	Sets **annual lending goals & risk appetite**. ✅
⬜ **Objectives Statement**	Defines **credit quality, risk tolerance & priority sector lending**.	Bank aims for **loan portfolio growth while maintaining low NPAs**. ✅
⬜ **Lending Authority & Responsibilities**	Specifies **who approves loans at different levels**.	A **Branch Manager can approve up to ₹5 crore, above that**

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		needs HQ approval. ✓
☐ **Controlling Authority**	Ensures **all major loan sanctions are reviewed at a higher level**.	A **₹100 crore corporate loan must be reviewed by the Credit Committee**. ✓
☐ **Sign-Off Process**	Ensures **loan proposals follow risk & credit policies** before approval.	A **screening committee verifies loan proposals before sanction**. ✓
☐ **Credit Denial & Recording Procedure**	Defines how **loan rejections are documented**.	A **loan denial must be recorded for regulatory audits**. ✓
☐ **Portfolio Composition & Diversification**	Sets **loan exposure limits per sector** to reduce risk.	Bank **limits real estate lending to 20% of total loans**. ✓

⬚ **Types of Loans**	Defines **all loan categories & borrower eligibility**.	Covers **retail, business, home, MSME, & corporate loans**. ✓
⬚ **Appraisal Standards & Procedures**	Specifies **how loans are evaluated & approved**.	A **loan applicant must submit financials & credit reports**. ✓

⬚ **3. Breakdown of Credit Policy Sections**

⬚ **(A) Purpose & Contents**

- Defines **what the Credit Policy seeks to achieve**.
- Reviews **economic environment, regulatory concerns & bank's business strategy**.

⬚**Example:**

A **bank sets loan growth targets** based on **last year's performance & economic trends**.

▣ (B) Objectives Statement

- **Maintaining asset quality** & ensuring **healthy credit growth**.

- **Managing risk-adjusted returns** on credit exposure.

- **Priority Sector Lending (PSL) targets** (Agriculture, MSMEs, Housing, Education, etc.).

- **Loan cut-off scores** (e.g., **minimum CIBIL score required**).

- **Defining restricted/banned loan categories** (e.g., speculative trading loans).

▣**Example:**

A **bank mandates a minimum CIBIL score of 750 for personal loans**.

▣ (C) Lending Authority & Responsibilities

- Defines **who can approve loans at different levels** (Branch, Regional Office, HQ).

- Specifies **loan approval hierarchy** (Board, Credit Committee, Loan Officers).

▣ **Example of Delegation of Lending Authority:**

Approving Authority	Loan Amount Approval Limit
Branch Manager	Up to ₹5 crore ✓
Regional Credit Committee	₹5 crore – ₹50 crore ✓
Corporate Office Credit Committee	₹50 crore – ₹200 crore ✓
Board of Directors	Above ₹200 crore ✓

Example:

A **Branch Manager can approve small business loans up to ₹5 crore, higher amounts need HQ approval**.

(D) Controlling Authority

- Higher-level authorities **review & monitor major loan sanctions**.
- Ensures **sanctions follow bank policy & risk guidelines**.

Example:

A **₹100 crore loan for an infrastructure project must be reviewed by the Credit Policy Committee**.

(E) Sign-Off Process

- **Screening Committees & Risk Officers must sign off** before loan sanctioning.

- Ensures **loans follow risk policies & regulatory guidelines**.

Example:

Before approving a **large corporate loan**, a **Risk Officer verifies if it meets risk & credit policy standards**.

(F) Credit Denial & Recording Procedure

- **Rejected loan applications must be documented** for regulatory & audit purposes.

Example:

A **bank refuses a loan due to a borrower's poor repayment history & records the reason for compliance**.

(G) Portfolio Composition & Diversification

- Defines **how much exposure the bank can take in different sectors**.

- Ensures **risk is spread across industries to avoid overconcentration**.

🔲 **Example of Loan Portfolio Diversification:**

Sector	Max Loan Exposure Limit (%)
🔲 **Real Estate**	15%
🔲 **Manufacturing**	20%
🔲 **Agriculture (PSL)**	25%
🔲 **MSME & Retail**	20%
🔲 **Trade & Exports**	20%

🔲 **(H) Types of Loans**

- Defines **loan categories** & **borrower eligibility**.
- Specifies **limits on syndicated loans & employee loans**.

⬜ **Example of Loan Types in Credit Policy:**

Loan Type	Purpose	Who Uses It?
⬜ **Home Loan**	Buying a house	Individuals & families
⬜ **Vehicle Loan**	Buying a car/bike	Salaried employees & professionals
⬜ **Business Loan**	Expanding business	MSMEs & corporates
⬜ **Education Loan**	Higher studies in India/abroad	Students
⬜ **Personal Loan**	Unsecured loan for personal use	Salaried & self-employed

⬜**Example:**

A **bank mandates that MSME loans require at least 3 years of business operations before approval**.

⬜ (I) **Appraisal Standards & Procedures**

- Defines **how loan applications are evaluated**.

- Specifies **financial documentation & credit assessment criteria**.

 Example: Loan Appraisal Criteria

Appraisal Factor	Evaluation Requirement
Credit Score	**Minimum CIBIL score of 750 required.**
Income Stability	**Salary slips, ITR, financial statements.**
Collateral	**Property, fixed deposits, guarantees.**
Business Viability	**Cash flow analysis for business loans.**

Example:

A **walk-in customer** applying for a **₹50 lakh loan must meet**

stricter appraisal standards than an **existing customer with a strong credit record**.

☐ Conclusion

A **strong Credit Policy ensures safe lending**, manages risks, and **aligns with regulatory & market conditions** ✓ By defining **loan approvals, risk exposure & compliance guidelines**, banks can **grow profitably while minimizing defaults** ☐☐☐.

🏢 Appraisal Standards in Bank Lending 📄 💰

✵ 1. What are Appraisal Standards?

✓**Definition:**

Appraisal standards are **scientific credit assessment methodologies** used by banks to **evaluate loan proposals & manage risks**.

✓**Purpose:**

- Ensures **accurate risk assessment before loan approvals**☐
- Helps **determine borrower's creditworthiness & repayment capacity** ✓

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- Defines **qualitative & quantitative criteria for loan appraisal**

- Supports **better loan pricing & risk management**

Example:

A **bank requires a minimum CIBIL score of 750 for personal loans & detailed cash flow analysis for business loans**. ✓

2. Key Methods of Loan Appraisal

Method	Description	Example
Security-Based	Loan is sanctioned against **collateral (e.g., property, FD, shares, gold)**.	**Loan against FD with 90% collateral coverage**. ✓
Balance Sheet-Based	Evaluates **financial strength through balance sheets & financial ratios**.	**A company with a strong debt-equity ratio gets a lower interest rate**. ✓

⬜ **Cash-Flow Based**	Assesses **repayment ability based on expected future cash flows**.	**Business loans sanctioned based on projected revenue**. ✅

⬜ 3. Qualitative vs. Quantitative Appraisal Criteria

Type	Description	Example
⬜ Qualitative	**Bank's loan policy framework, sector risk limits & borrower reputation**.	Bank **caps real estate loans at 15% of total portfolio**. ✅
⬜ Quantitative	**Financial parameters, liquidity ratios, credit ratings & turnover trends**.	Borrower must have **DSCR of at least 1.5** for loan approval. ✅

⬜ 4. Qualitative Loan Appraisal Criteria

⬜ **(A) Exposure Limits for Borrowers & Sectors**

- Defines **maximum exposure to a single borrower/group**.

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- Limits exposure in **risky sectors like real estate, steel, capital markets**.

- Adjusts exposure based on **market conditions & regulatory changes**.

⬜ **Example:**

A **bank reduces lending to the IT sector due to rising market risks**.

⬜ **(B) Discretionary Loan Approval Powers**

- Defines **who can approve different loan amounts**.

- Specifies **approval limits for overdrafts, ad hoc loans & special cases**.

⬜ **Example: Loan Approval Limits**

Approving Authority	Loan Amount Limit
Branch Manager	Up to ₹5 crore ✓
Regional Credit Committee	₹5 crore – ₹50 crore ✓
Corporate Office Credit Committee	₹50 crore – ₹200 crore ✓
Board of Directors	Above ₹200 crore ✓

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5. Quantitative Loan Appraisal Criteria

(A) Working Capital Loans – Key Ratios

Financial Parameters for Loan Approval

Parameter	Purpose	Example
Liquidity	Measures borrower's ability to meet short-term obligations.	**Current ratio should be at least 1.33**. ✓
Financial Soundness	Ensures stable debt levels & financial health.	**Debt-equity ratio < 2.0 is preferred**. ✓
Turnover Trends	Evaluates business stability & revenue growth.	A company must have **consistent 10%+ YoY growth**. ✓
Profitability	Ensures borrower generates sufficient income for repayments.	**EBITDA margin should be above 15%**. ✓

⬛ **Credit Rating**	External ratings impact loan pricing & risk weight.	**BBB- or higher required for concessional rates**. ✓

⬛**Example:**

A company with **high profitability but low liquidity** may **need to pledge additional collateral**.