

## CREDIT SCORING

### RISK

Risk refers to the **possibility of experiencing harm, loss, or negative consequences** due to **uncertain events or circumstances**.

### TYPES OF RISK

#### Credit Risk

It is a potential financial loss if a **customer fails to repay a loan or fulfil financial obligations**.

#### Business Risk

It is a potential loss or negative impact on a company's profitability or value **due to operational or strategic factors**.

#### Market Risk

It is a potential financial loss due to **fluctuations in market prices or external factors**.

#### Operating Risk

It is a potential losses or disruptions in **business operations due to internal factors** and it includes risks associated with **process failures, technology failures, fraud, or inadequate internal controls**.

## **CREDIT SCORING**

- Credit scoring is a **statistical analysis performed by lenders and financial institutions** to determine the **creditworthiness of an individual.**
- In India, **credit scores** are **evaluated and monitored by Credit Information Companies (CICs).**

## **CREDIT SCORES**

- A credit score is a **statistical number that evaluates a consumer's creditworthiness** and is based on credit history.
- Lenders use credit scores to **evaluate the probability** that an individual will repay his/her debts.
- Credit scores range from 300 to 900 - with **900 being the best score** and **300 being the worst.**

## **CREDIT INFORMATION COMPANY**

- It is a financial institution or agency that **collects, stores, and disseminates credit-related information** about individuals and businesses.

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- These companies gather data from various lenders, such as **banks, credit card companies, and other financial institutions**, to assess the creditworthiness of borrowers.
- Credit Information Companies in India are **licensed by the Reserve Bank of India** and **governed by the Credit Information Companies Regulation Act, 2005.**

### **CREDIT INFORMATION COMPANIES (CICs) IN INDIA**

#### **TransUnion CIBIL**

- CIBIL was incorporated in **August 2000** based on the **recommendations made by the Siddiqui Committee.**
- It commenced commercial bureau **operations in May 2004.**
- CIBIL has more than **500 members** including more than **200 cooperative banks.**
- The CIBIL **credit score** varies from 300 to 900.

#### **Experian**

- Experian Credit Information Company was established as a **joint venture with several banks and financial institutions** in India in **2006.**

JAIB with **Learning Sessions.** <https://iibf.info/app>

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- Experian prepares **credit reports of individuals**, based on the information provided by banks and other financial institutions

### **Equifax**

- Equifax is a CIC that was founded in the year **1899 in Atlanta**.
- Equifax got its **Certificate of Registration** for its operations in India **in the year 2010**.

### **CRIF High Mark Credit Information Services**

It serves retail, agriculture and rural, MSME, commercial and microfinance.

### **MEMBERSHIP TO CIC**

**Membership to a CIC is available to Credit Institutions.**

- Banks, RRBs, Cooperative banks, NBFCs, Public Financial Institutions, Housing Finance Institutions.
- **Companies** engaged in the business of **credit cards and other similar cards**.
- **Companies** dealing with **distribution of credit** in any other manner or any other institution.

### **Credit Information Companies (Regulations) Act, 2005**

- The Credit Information Companies (Regulation) Act, 2005 is enacted with an objective to regulate the working and the action of the Credit Information Companies.
- The RBI has further issued **Credit Information Companies Regulations, 2006** to facilitate the smooth working of CIC.

### **REGULATORY GUIDELINES GOVERNING CIC**

- The CIC Act, 2005 provides for the functioning of CIC, its registration procedure, settlement of dispute.
- Section 15 of the CICRA, every Credit Institution is required become member of at least one CIC.
- Section 17 of CICRA stipulates that a CIC may seek and obtain credit information from its members only.

### **CURRENT SCENARIO**

- All banks and concerned financial institutions are members of all CICs.
- No CIC should charge membership fee and annual renewal fees exceeding Rs. 10,000 and Rs 5,000, respectively.

## **GOOD CREDIT SCORE**

- Whether a score is **good or not will depend on the bank's internal policy, its customer profile, and its risk appetite.** Some banks may perceive **700** as a **good score** and **another may not.**
- **In India,** different banks will rank different scores as good. Still, any score over **700** may be considered **good by banks.**
- But a credit score is only an **indicative tool for managing risk and its effectiveness** depends on the **bank's internal control mechanism.**

## **CREDIT SCORING MODEL**

- A credit scoring model is a **mathematical model** used to **estimate the probability of default.**
- In a credit scoring model, the **probability of default** is normally presented **in the form of a credit score.**
- The higher score refers to a **lower probability of default and vice versa.**

**CICs typically build scores using three historical data files**

- Defaults on previous credit transactions.
- Payment behaviour/Payment history.
- Previous searches/inquiries.

## **MANAGING THE CREDIT SCORE**

It refers to **taking actions and adopting strategies to maintain or improve** an individual's or business's **creditworthiness as reflected in their credit score.**

### **Credit Utilization**

- It refers to the **percentage of available credit that you are currently using**. It is an essential factor that impacts your credit score.
- Managing credit utilization involves keeping your credit card balances and overall debt levels as **low as possible compared to your total available credit**.
- Maintaining a low credit utilization ratio, **ideally below 30%, is generally considered favourable for credit scores.**

## **Payment Defaults**

- **Payment defaults occur when you fail to make timely payments on your credit accounts**, resulting in negative consequences.
- **Managing payment defaults involves making payments on time and avoiding late payments** or defaulting on any credit agreements.

## **Trade Attributes**

- Trade attributes refer to various factors that influence your creditworthiness and credit score.
- These include your payment **history, credit age, types of credit accounts, and recent credit inquiries.**

## **WARNING SIGNS IN CREDIT SCORE**

These are indicators that **suggest potential issues or risks associated with an individual's creditworthiness.**

- Late Payments
- High Credit Utilization
- High Debt Levels
- Multiple Credit Applications
- Foreclosure or Bankruptcy



- Inaccurate or Suspicious Information

## **CREDIT INFORMATION REPORT**

- It is also known as a credit report, is a detailed **document that provides information** about an individual's or business's **credit history and creditworthiness**.
- It is a key component in credit scoring and plays a significant role in **assessing creditworthiness and determining credit scores**.

## **BENEFITS OF USING CREDIT INFORMATION REPORT**

**Financial Analysis:** Helps analyse your true financial standing and make informed plans for future finances.

**Debt Management:** Enables you to stay on top of your borrowings and avoid falling into debt traps.

**Better Credit Decisions:** Allows you to make informed decisions about new credit opportunities and negotiate better rates with lenders.

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**Financial Discipline:** Cultivates financial discipline by providing a comprehensive view of your credit history and payment habits.

### **FACTORS LEADING TO FAVOURABLE CREDIT SCORE**

- On-time Loan EMI Payments
- Regular Credit Card Bill Payments
- Paying Credit Card Bills in Full
- Avoiding Over-leveraging
- Maintaining Strong Financial Records
- Proper Utilization of Approved Credit Limit

### **FACTORS LEADING TO NEGATIVE CREDIT SCORE**

- Excessive Credit Report Enquiries
- Cheque Bounces/Dishonours
- Irregular Loan Repayments
- Defaulting on Credit Card Bills
- Too Much Unsecured Credit
- Rejection of Unsecured Loan Applications
- Defaulting as a Guarantor
- High Utilization of Approved Credit Limit

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- Non-Payment of Utility Bills
- Errors in Credit Records

### ADVANTAGES OF MAINTAINING HIGH CREDIT SCORES

- Easy Availability of Credit
- Quick Processing of Loan
- Quick Processing of Credit Card Applications
- Ability to Negotiate Interest Rates
- Possibility of Waiving Processing Fees
- Option to Choose Prepayment Options

### MISTAKES IN CREDIT SCORING

#### Confusion of Names

- There can be **lakhs of names that are similar** in the CIC's database.
- Things can go haywire **person with your name has defaulted** and all **his defaults get recorded in your file.**

#### Human Input Error

The information that goes from the banks to the CIC on a default may have been erroneous due to a **simple input error by one of the bank employees.**

## **Identity Theft**

When an **individual's personal information is stolen**, fraudsters can use it to open fraudulent accounts, make unauthorized transactions, or take out loans in the victim's name.

## **TROUBLESHOOTING CREDIT SCORE**

### **Contact the Bank/Lender**

- Reach out to the bank or lender that **declined your credit card or loan application**. and request clarification on the **reasons behind your poor credit score**.
- Ask them to provide the **control number** associated with **your credit report**.

### **Obtain the Control Number and Credit Report Information**

- Once you receive the **control number from the bank**, it serves as a unique **identifier for your credit report**.
- The control number allows you to access the **specific details that the bank** saw when they reviewed your report.
- The bank will also share the information from your **credit report that contributed to your poor credit score**.

**Resolve Disputes through Credit Information Companies (CICs)**

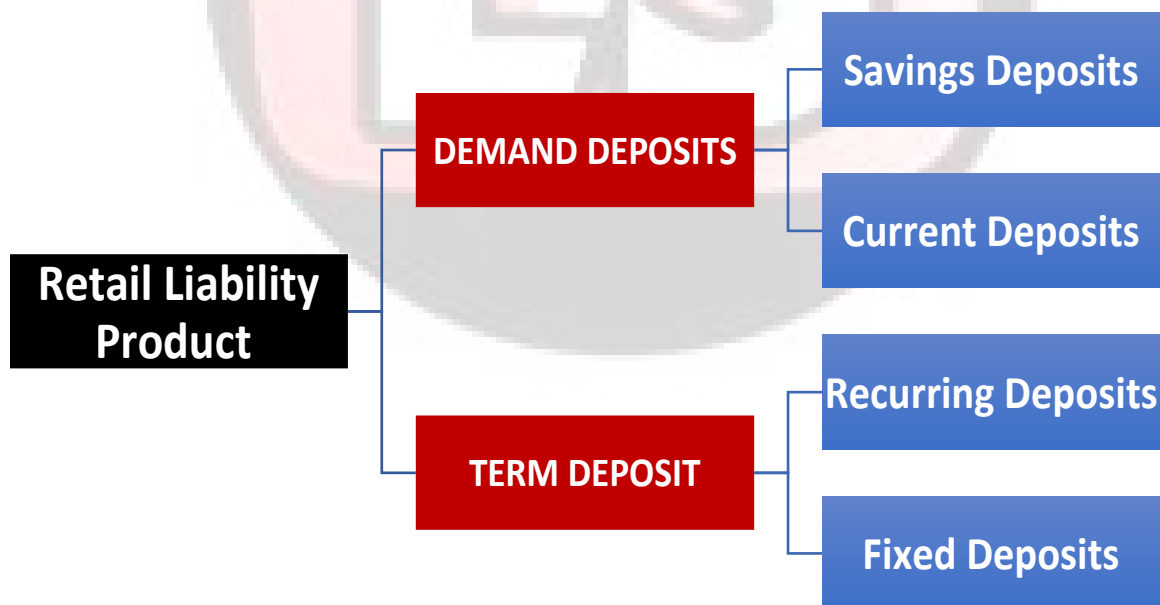
Visit the website of the relevant Credit Information Company (CIC) or credit bureau and explore the **provisions and guidelines provided by the CIC for resolving disputes.**



## IMPORTANT RETAIL LIABILITY PRODUCT

### RETAIL LIABILITY PRODUCT

- It refers to **financial products and services** offered by banks to **individuals and small businesses** that involve the **acceptance of deposits or funds from customers**.
- These products are typically used by customers to **store their money, make payments**, and conduct various banking transactions.



## **DEMAND DEPOSITS**

It refers to funds held in a bank account that can be **withdrawn by the account holder** at any time **without any advance notice or restrictions**.

## **CURRENT DEPOSITS**

- These are bank accounts that are **primarily used for conducting frequent and regular financial transactions**.
- They are typically held by **businesses, corporations, and individuals** who require a **high level of liquidity** and need to make frequent payments or withdrawals.

## **FEATURES**

- There are **no restrictions** on the **number of withdrawals** in the account except in certain cases.
- **Overdraft facility** is permitted with prior arrangement.
- **Checkbooks** are issued in all current accounts with certain exempt exceptions.

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- RBI directives **prohibit payment of interest** on current accounts except with the prior approval of the RBI.

### **DOCUMENTS REQUIRED FOR OPENING CURRENT ACCOUNTS**

**Individuals (singly/jointly):** A certified copy of an OVD, as mentioned in the **Master Directions on KYC**, containing details of the **identity and address** of the individual shall be obtained.

**Sole proprietary firm:** A certified copy of an OVD, as mentioned in the **Master Directions on KYC**, containing details of the **identity and address** of the individual (proprietor) shall be obtained.

#### **And Certified copy of any two of the following**

- Registration certificate.
- Certificate/license issued by the municipal authorities under Shop and Establishment Act.
- Sales and income tax returns.



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- Complete Income Tax Return in the **name of the sole proprietor** where the firm's income is reflected, duly authenticated/ acknowledged by the Income Tax authorities.
- Utility bills such as **electricity, water, and landline telephone bills.**

### **Partnership Firm**

- Registration certificate
- Partnership deed
- Officially valid documents in respect of the person **holding an attorney to transact on its behalf,**
- PAN card of the entity.
- OVD of all the partners as per master directions on KYC

### **Hindu Undivided Family (HUF)**

- Joint Hindu Family letter
- A **certified copy of an OVD**, as mentioned in the master directions on KYC, containing details of the **identity and address of the individual operating the account** shall be obtained.

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- PAN Card of the HUF

### **Limited Liability Partnership Firms**

- Certificate of Incorporation
- Copy of Resolution
- PAN Card of the LLP firm
- **OVD of the designated partners** as per master directions on KYC

### **Limited Companies**

- **Certificate of incorporation and Certificate of Commencement of Business** in the case of public limited companies
- Memorandum of Association
- Article of Association
- **A resolution from the Board of Directors** and power of attorney granted to its **managers, officers, or employees to transact on its behalf.**
- Officially valid documents in respect of **managers, officers, or employees** holding an attorney to transact on their behalf.
- PAN Card of the entity

### **Co-operative Societies**

- **Certificate of registration** associations, clubs, etc. of the society/association/club if any
- Certified copy of the **bye laws of the society** etc.
- **Resolution of the managing committee**, appointing the bank as its bankers and **stipulating the conditions** for the conduct of the account.

### **Charitable or Public Trust**

- Registration certificate
- Trust deed
- **Officially valid documents** in respect of the person holding a power of attorney to transact on its behalf.

### **Transgender Persons**

- Banks have been advised by RBI to refer to the **judgment dated April 15, 2014**, of the Supreme Court in the case of **National Legal Services Authority v. Union of India** and

others on **treating all transgender persons as 'third gender'**.

- Banks should, therefore, **include 'third gender' in all forms/applications**, etc. prescribed by the Reserve Bank or the banks themselves, wherein any gender classification is envisaged.

## **IMPORTANT POINTS REGARDING OPENING OF CURRENT ACCOUNT**

### **Acceptance of Cash and Cheques**

When opening a current account, **banks typically accept both cash and cheques as an initial deposit**. This allows customers to fund their accounts using either form of payment.

### **Acceptance of Cheques from Another Bank**

Banks may also **accept cheques from another bank** that are drawn on the account of the **customer opening the current account**. This can serve as an initial deposit, indicating the customer's intention to transfer funds from their existing bank to the new current account.

## **Verification of Credit Facilities**

Before opening a current account for a company or firm, banks need to ensure that the entity does not have any outstanding credit facilities with other banks or branches.

### **Borrowers with Exposure Less than Rs. 5 Crore**

- There is **no restriction on the opening of current accounts** or on the provision of **CC/OD facility by banks,**
- Borrowers **shall inform the bank(s),** as and when the credit facilities availed by them from the **banking system reaches Rs. 5 crore or more.**

### **Borrowers with Exposure of Rs. 5 Crore or More**

- Borrowers can maintain **current accounts with any one of the banks with which it has a CC/OD facility,** provided that the bank has **at least 10 percent of the exposure** of the banking system to that borrower.
- **Other lending banks** may open only **collection accounts subject to the condition** that funds deposited in such **collection accounts will be remitted within two working days** of receiving such funds, to the **CC/OD account**

**maintained with the above-mentioned bank** maintaining current accounts for the borrower.

### **MONITORING OF NEWLY OPENED ACCOUNTS**

- "Know Your Customer" (KYC) guidelines should be **followed** in respect of opening accounts and monitoring of newly opened accounts.
- In case of **third-party credits** are allowed in newly opened accounts, the **genuineness of the transactions** is to be verified from the bank's end.
- Except for exceptional circumstances, **proceeds of instruments** like cheques, dividend interest warrants, refund orders, and crossed " A/c Payee" cheques should invariably **be credited to the payee's account only.**
- Every Account holder should be **supplied with statements of accounts every month without any charge.**

## **TRANSFER OF ACCOUNTS**

- As per recommendations of the **Damodaran Committee on Customer Service**, **IBA has given direction** for implementing the facility of **account number portability**.
- It means the customer is allowed to **maintain the same a/c number** in the bank even when he/she moves to another city or shifts his a/c to another branch in the same city.

## **INOPERATIVE ACCOUNTS**

- Current accounts where there are no operations **continuously for two years**, should be treated as inoperative accounts.
- The account can be made operative **after the bank is satisfied with the reasons for non-operation** and fresh KYC documents are obtained and duly verified.

## **CLOSURE OF CURRENT ACCOUNT**

- Whenever a customer wants to close his account, a bank should **endeavor to ascertain the specific reasons** for the

closure of the same.

- Bank should persuade the **account holder to continue the account, if possible.**
- If the customer wishes to close the account due to genuine difficulties or constraints, the **bank branch should obtain a letter requesting the Bank to close the account** duly signed by all the account holders/ partners.

### **SAVINGS DEPOSITS**

- It also known as **savings accounts**, are bank accounts that are designed to **help individuals or households save money over time.**
- These accounts offer a **safe and secure place to store funds** while **earning interest on the deposited amount.**

### **FEATURES**

- Savings deposits **earn interest, allowing money to grow over time.**
- **Withdrawals** from savings deposits are allowed, but there **may be limits to encourage saving.**



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- Savings deposits are generally considered **safe due to financial regulations and deposit insurance.**
- Some savings accounts **have minimum balance requirements** to avoid fees or gain additional benefits.

### **Advantages And Importance of Savings Bank Deposits To Customers**

- Saving account **encourages savings habit** among salary earners and others who have fixed incomes.
- It enables the depositor to **earn income by way of saving bank interest.** A saving account helps the depositor to **make payments by way of issuing cheques.**
- Saving account **passbook** acts as an **identity and residential proof** of the account holder.
- It provides a facility such as **electronic fund transfer (EFT)** to other people's accounts.
- It helps to do **online shopping** via facilities like internet banking.

## **Advantages and Importance of Savings Bank Deposits to Bank**

- Savings deposits are a **valuable component of CASA deposits** for banks, these accounts provide a **broad retail deposit base**.
- It helps banks to support their income or profits **through low-cost deposits** which can be profitably deployed into high-yielding advances and thereby provide **better interest spread and margin**.
- Provides potential customer base for marketing other products and **relatively stable in nature**.