

# Bank Branch Audit – Advances

At Shivaji Park Study Circle  
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# Disclaimer

- The views expressed in the following presentation should not be construed as the view of ICAI or my firm.
- The views opined herein should not be considered as a professional advice

# Importance

- Most **Important** Area in Bank Audit
- 50 % Of our Total Time is spend on this Area
- In a Given Max 6 days working
- Expected **100 % checking** in Statutory Audit At least for Large Ticket Advances
- Various types of **frauds and queries** are observed in this area
- Specialized **skill and thorough Knowledge** required
- Various **Norms , Policies ,Powers** , Various Act and Rules need to be studied.

# Loans and Advances

- Loans and advances is a **principal businesses** activity of banks.
- Loans are sanctioned on certain **terms and conditions** and usually borrower offer some assets as a **security** for the loans given.
- These assets may be **movable or immovable** upon which **charge is created** in favour of the bank.

# Points For Discussion

- Types of Loans & Advances
- Sector Wise Classification
- Security wise Classification
- Prudential Norms Wise Classification
- Restrictions on Loans and Advances
- Pre Sanction Verification
- Importance of Documentation
- Verification of Loans & Advances in Detail
- Various Charges Created in Loans & Advances.
- Monitoring
- Other Related Topics

# Types of Loans & Advances

# Types of Loans & Advances

- **Fund Based** :- Advances are those where there is an **actual transfer** of **funds** from the bank to the borrower.
- Term Loans
- Cash Credit
- WCTL
- Overdraft
- Bill Discounting / Bill Purchase / Foreign Bills for collection / Advance against bills for collection
- Exports Credit–Pre/Post Shipment
- Imports Credit–Capital Goods/RM

# Types of Loans & Advances

- **Non Fund Based** :- Advances are those where there **is no involvement of transfer of funds** from the bank to the borrower.
- Letter Of Credit
- Bank Guarantees,
- Co-acceptance Of Bill.

Although in certain cases a **non fund** facility may subsequently **turn into a funded** facility.

E.g. where the bank makes payment under a letter of credit issued by it due to **devolvement** , **Revocation** of BG etc ...



# Sector wise classification

# Sector wise classification

- Priority
  - Agriculture
  - Education
  - Housing
  - Export credits
  - MSME
  - Social Infrastructure
  - Renewable energy
  - Others
- Non Priority
  - Sectors other than priority are covered under non priority sector

# Priority Sector - Target

- Domestic scheduled commercial banks and Foreign banks **with 20 branches** and above
- **40 percent of Adjusted Net Bank Credit** or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher
- Foreign banks with **less than 20** branches
- **40 percent of Adjusted Net Bank Credit** or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher; to be **achieved in a phased manner by 2020**

# Priority Sector - Target

- Total priority sector lending – 40%
- Agriculture Loan - 18%
- Micro Enterprises – 7.5%
- Advance to Weaker Section – 10 %

# Sector wise Limitations

- Priority Sector **Housing Loan** :  
In Metropolitan Centres (Population 10 lacs and above)- **Loans upto Rs. 28 lacs** provided overall cost of **dwelling unit not to exceed Rs. 35 lacs**  
In case of repairs, amount restricted to **Rs. 5 lacs**
- In Other Centres - **Loans upto Rs. 20 lacs** provided overall cost of **dwelling unit not to exceed Rs. 25 lacs**  
In case of repairs, amount restricted to **Rs. 2 lacs**
- Priority Sector **Education Loans – Upto Rs 10 lacs**

# Sector wise Limitations

- Micro, Small and Medium Enterprises Actually no such limit but :-  
Banks Funds **upto 5 Cr to Micro and Small**  
Rs **10 Cr to Medium**
- For Social Infrastructure :-  
Rs. **5 crore per borrower for building social** infrastructure for activities namely schools, health care etc.

# Sector wise Limitations

- Renewable Energy :-
- Bank loans up to a **limit of Rs. 15 crore to borrowers for purposes like solar based power generators**, biomass based power generators, wind mills, micro-hydel plants and for non-conventional energy based public utilities *viz.* street lighting systems, and remote village electrification
- **individual households, the loan limit is Rs. 10 lakh per borrower.**

# Security wise classification



# Security wise classification

- Security Wise classification
  - Secured - by **tangible assets**
  - **Unsecured**

**Improper classification** results in over /under provisioning .

Also affects **the rating of the branch.**

# Prudential Norms Wise Classification

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## Standard Loans

Regular

Special mentioned accounts ( SMA )

## NPA loans

Sub standard Loans

Doubtful

Loss

# Prudential Norms Wise Classification

- **SMA- 0** RBI Circular No :-  
BOD.BP.BC.No.97/21.04.132/2013-14 dated February 26,  
2014
- Few illustrative sign of stress in the account for classification as SMA 0 are :
- **Returning of 3 or more cheques** issued by borrower in 30 days
- Actual **sales or profit falling short by 40%** or more as compared to projections at the time of sanction
- **Non payment of devolved LC/Invoked Bank Guarantee** within 30 days
- **Third request for extension of time for creation of securities against time specified in the sanction**

# Prudential Norms Wise Classification

- SMA 0 (Overdue upto 30 days)
- SMA 1 (Overdue between 31 to 60 days)
- SMA 2 (Overdue between 61 days to 90 days)

# Consequences Of NPA

- Causes a **direct hit on the bottom line of the bank** when an account becomes NPA due to :
- **No further interest** is to be charged since the date of account becoming NPA
- **Reversal of all unrealized interest** in the account
- **Provisioning through P&L account** on the balance as per the norms. The total amount of provisions as compared to the gross NPA is known as Provision Coverage Ratio.

# Provisioning

## STANDARD

- GENERAL 0.40%
- AGRICULTURE & MSME 0.25%
- REAL ESTATE 0.75%

## SUBSTANDARD

- SECURED PORTION 15%
- UNSECURED 25%

## DOUBTFUL

- D-1 (UPTO 1 YEAR) 25%
- D-2 (1 TO 3 YEARS) 40%
- D-3 (OVER 3 YEARS) 100%
- UNSECURED PORTION 100%

# **Restricted as per Sec 20 of Banking Regulations Act**



# Statutory Restrictions

- Advances against bank's own shares u/s 20(1) cannot grant any **loans and advances on the security of its own shares**
- Advances to bank's Directors 20(1) - lays down the restrictions on loans and advances to the **directors and the firms in which they hold substantial interest** .  
Purchase of or **discount of bills** from directors and their concerns, which is in the nature of **clean accommodation, is reckoned** as 'loans and advances'

# Statutory Restrictions **NOT** Applicable

- When director is **director in a Government Company**
- When director is **director a subsidiary of the Banking Company**
- When director is director and **Company** registered under **Section 8 of** the Companies Act 2013.

# Restrictions on Holding Shares in Companies

While granting loans and advances against shares, statutory provisions contained in Sections 19(2) and 19(3) of the Banking Regulation Act, 1949 should be strictly observed.

- (2) Save as provided in sub-section (1), no banking company shall hold shares in any company, whether as pledgee, mortgagee or absolute owner, of an **amount exceeding thirty per cent.** of the paid-up share capital of that company or **thirty per cent. of its own paid-up share capital and reserves, whichever is less:**

# Restrictions on Holding Shares in Companies

- banking company shall **not, after the expiry of one year from the date of the commencement of this Act,** hold shares, whether as pledgee, mortgagee or absolute owner, in any company in the management of which any Managing Director or manager of the banking company is in any manner concerned or interested.

# Restrictions on Credit to Companies for Buy-back of their Securities

- Companies Act, 2013, companies are **permitted to purchase their own shares** or other specified securities out of their
  1. free reserves, or
  2. securities premium account, or
  3. the proceeds of any shares or other specified securities
  4. **subject to compliance** of various conditions specified therein.
- **Therefore, banks should not provide loans to companies for buy-back of shares/securities.**

# Regulatory Restrictions

- Granting loans and advances to relatives of Directors
- Restrictions on Grant of Loans & Advances to Officers and Relatives of Senior Officers of Banks
- Restrictions on Grant of Financial Assistance to Industries Producing / Consuming Ozone Depleting Substances (ODS)
- Restrictions on Advances against Sensitive Commodities under Selective Credit Control (SCC)
- Restriction on payment of commission to staff members including officers
- Restrictions on offering incentives on any banking products

# Selective Credit Control (SCC)

- The commodities, generally treated as sensitive commodities are the following:
  - (a) food grains i.e. **cereals and pulses**,
  - (b) **selected major oil seeds** indigenously grown, viz. groundnut, rapeseed/mustard, cottonseed, linseed and castor seed, oils thereof, vanaspati and all imported oils and vegetable oils,
  - (c) raw **cotton and kapas**,
  - (d) **sugar/gur/khandsari**,
  - (e) **Cotton textiles** which include cotton yarn, man-made fibres and yarn and fabrics made out of man-made fibres and partly out of cotton yarn and partly out of man-made fibres

# Restricted as per Sec 20 of Banking Regulations Act

- Firm in which director is partner , guarantor or employee
- Company in which director is director, guarantor, employee or holds substantial interest
- Loans to relatives of the director- permission of the Board of Directors required.
- Prohibits advance against its own shares
- No new loans to firms having HUF or NBFC as partner.



# Restricted as per Sec 20 of Banking Regulations Act

- No loans for investing in small savings instruments including Kisan Vikas Patra
- No loans against partly paid up shares
- No loans to partnership/Proprietorship concern against primary security of shares and debentures.

# Verification Of Advances

# Steps in Verification

- Loan Application
- Pre Sanction Verification
- Documentation
- Post Sanction verification
- Monitoring of the Advance

# Loan Application

- **Must be** in Bank Format
- Details of the **Borrower ID proof / Income Proof / Residential Address Proof**
- Details of the **Guarantors ID proof / Income Proof / Residential Address Proof**
- **KYC** To be Verified from Original and Self Attested
- **Purpose** of loan
- **Assets to be purchased details / Project Report**
- **Technical and Economical** Analysis

# Pre Sanction

- Basic **policies** of the Bank for Finance
- Verification of **status** of borrower , proprietorship proof / Partnership Deed / MA & AA / Society registration / trust registration deed etc ,
- **Financial Documents** of Borrower and Guarantor like ITR, Balance Sheet , Audit reports etc
- **Various registrations** like PAN / TAN, Vat / service tax registration , IEC Registration / SSI registration etc

# Pre Sanction

- **Due diligence** for identification of the borrower including pre sanction visit
- Direct **third party verification** of documents
- Generation of **CIBIL reports**, reference to **RBI defaulters list, ECGC caution list**
- Satisfactory **status report** from the existing bankers
- Credit **risk rating** done
- **Site verification** and valuation of immovable properties by **approved valuer** and branch official

# Pre Sanction

- **CERSAI Verification** for any existing charge on immovable property.
- **ROC** search
- **Assessment of limit** as per the guidelines
- Loan granted within **the discretionary power**
- Compliance of **Bank's lending policy** stipulations
- Compliance of **take over norms**
- **Process Notes** of various Authorities Bm, Regional Manager etc.
- Issuance of sanction letter

# Documentation



# Documentation- Definition

- **Section 29 of Indian Penal Code, 1860** states that the document denotes **any matter** expressed or described upon any **substance by means of letters, figures or marks** or by more than one of these means, intended to be used or which **may be used as evidence** of that matters.

# Documentation - Definition of Instrument

- Section 2(14) of Indian Stamp act, 1899 defines instrument.
- Instrument is also a “document and includes affidavits”.
- A document creates or purports to create a right or liability.
- However, a copy of document cannot be termed as instrument because it does not itself create any right or liability.
- It is also required that a document must be executed by the parties concerned to make a document an instrument.

# Documentation - Importance

- Documents are the **means** which prove and establish before a **court of law** that the **money was lent** and the same has not been repaid.
- **Invalid/Time barred documents affect** the Bank 's **right to recover** the loans through the court of law.
- **Process of execution** of documents known as **Documentation**

# Documentation - Commonly Used Documents

- Demand Promissory notice
- Loan Agreement
- Hypothecation deed
- Guarantee Agreement

# Documentation - Ingredients of Documents

- Properly **filled, duly stamped and signed** by the borrower and guarantor
- Proper **value of stamp** or stamp paper to be used
- **Date of stamp paper** to be before the date of execution
- Stamp Paper to be in the **name of the borrower** or the Bank
- **Overwriting/Cuttings** to be **duly authenticated**

# Documentation - Ingredients of Documents

- Execution of documents by the legally competent persons
- Documents **to be alive**
- Documents on the **printed format** of the Bank.
- No computer generated documents **except through LAPS** (Loan Application Processing System)

# Documentation - Who Can Not Execute

- Persons **not legally competent to execute** the documents:
  - a. Minor,
  - b. Insolvent,
  - c. Insane,
  - d. Person of unsound mind,
  - e. Heavily drunk person

# Documentation - Limitation Period

- Normally **3 years**.
- In case of term loans, **3 years to be reckoned from the date of default**
- Limitation period can **be extended** through
  - **Obtaining fresh** documents
  - **Section 18 of the Limitation Act** extends the period of limitation “when an acknowledgement of debt is obtained in writing “



# Documentation - Limitation Period

- **Obtaining Balance** confirmation
- **Part payment in the account**
- **A debit entry shown on the Liability side of a borrower's balance sheet** i.e., of a Limited Company, signed by its agents is considered an acknowledgement of debt

(Babulal Rukmandand vs. Official Liquidator 1968, 1, com.lj).

# Documentation - General

- **Acceptance** of sanction by Borrower and Guarantor
- **All** required documents **executed**.
- Requisite stamp duty as per **the state laws**
- **Entry in document register** made
- **Vetting** of documents by panel advocate
- **Creation of Equitable** Mortgage as per the guidelines
- **CERSAI registration** in case of Equitable Mortgage of property

# Documentation – General

- Charge registration **with ROC** in case of company
- **Insurance of assets** taken as primary or collateral security
- Entry in the **system with proper masters**
- **End use confirmation** Like Tax Invoice or Purchase of Assets or Agreement copy etc
- **Margin confirmation** Like certificate from CA

# Documentation - Important Aspects Of ROC Charge Registration

- Covered under **Section 77** of the Companies Act 2013
- Charge is required to be **registered within 30 days** . However, additional 270 days are allowed to file charge with additional fee.
- Charge is required to be created **for all assets** (tangible as well as intangible)

# Verifications OF Loans

# Fund Based

# Term Loans

- Available for **acquiring fixed** assets
- Assets may be **Movable or immovable**
- Repayment in a **fixed period**
- Generally **Fixed Rate** is applied
- **Moratorium** may be available
- **Project Report** needs to be submitted
- **End use verification** and **visit** is expected
- May be **for original or for Resale** Assets

# Term Loans

- **TEV study** wherever applicable done
- All **project approval obtained** and held in records
- **Satisfactory credit report** of suppliers of machineries from the **approved rating agency** available
- **Funds released** on basis of **quotations available after keeping prescribed margin**
- **Bills in support** of assets acquired available in records
- **Insurance** of machineries done
- **Post disbursement inspection made**



# Term Loans - Retail loans

- Housing Loan
- Car Loan
- Education Loan
- Loan against FDR's
- Loan against LIC Policies
- Loan against securities
- Gold Loan

# Term Loan - Housing Loan

- **Original Agreement** between builder and borrower
- If in **2<sup>nd</sup> sale then chain Agreement** till last sales agreement between buyer and seller
- Along with **registration receipts & payment of stamp duty in original**
- **NOC** from society or Builder
- **Letter of Awareness** to builder / society
- **Non Encumbrance Certificate (NEC)** from panel advocate

# Term Loan - Housing Loan

- Or **Title** clearance
- **Valuation by approved valuer** in case of 2<sup>nd</sup> sale
- Creation of valid **mortgage**
- **CERSAI** registration
- Notice of Intimation
- **Insurance of house** property

# Term Loan - Housing Loan

- Construction of House :
- As per RBI circular No DIR.BC.13/08.12.001/2015-16 dated 1/7/2015 , **compliance of following guidelines :**
- Availability of **sanction plan from the competent authority** in the name of the applicant
- **Submission of completion certificate within 3 months** from the date of completion. Failure leads to giving right to the Bank to recall the loan.

# Term Loan - Housing Loan Loan To Value (LTV ) Ratio

- As per RBI Circular DBOD.No.DIR.BC.18/08.12.001/2014-15 dated 1/7/2014, the following LTV ratio to be maintained by the Banks in case of housing loans

<u>Category</u>	<u>LTV Ratio (%)</u>
• Upto Rs. 20 lakh	90
• Above Rs 20 lakh & upto Rs. 75 lakh	80
• Above Rs 75 lakh	75

# Term Loan - CAR LOAN

- Loan Application
- Vehicle **Quotation**
- **Margin Money** deposition
- **KYC** and due diligence
- **Proper appraisal** of limit
- Release of loan on basis of **quotation of car**
- Either **Direct transfer** to the car dealer or transfer to borrower account subject to proof of full payment
- **Bill and insurance** of car to be obtained
- **RC to be submitted** by the borrower and **charge** Noting
- **Post disbursement inspection of the car**

# Term Loan - Education Loan

- Proper KYC and due diligence
- Education from accredited Institution/University
- Original payment receipts of fee paid
- Periodic progress report of student borrower
- Interest on interest collection flag to be marked as 'Y' after the start of EMIs.

# Term Loan - Education Loan

- Repayment period: **Course period + 1 year or 6 months after getting job, whichever is earlier.**
- Maximum quantum of finance in **India Rs. 10 lakhs and abroad Rs. 20 lakhs**
- **1% int. concession** if interest is serviced during moratorium period (concession available for moratorium period only)
- Security and Margin –



# TL Education loan - Security and Margin

Particulars	Margin	Security
Upto ₹ 4 lakhs	Nil	Parents to be joint borrower(s). Banks have a discretion to waive this.
Above ₹ 4 lakhs and upto ₹ 7.5 lakhs	In India – 5% Abroad – 15%	Parents to be joint borrower(s). Plus third party guarantee.
Above ₹ 7.5 lakhs	In India – 5% Abroad – 15%	Parents to be joint borrower(s). Plus tangible collateral security.

# Term Loan - GOLD LOAN

- Loans against **pledge of gold ornaments**
- Banks required to maintain a **minimum LTV** (Loan to value ratio) of **75%** of value of gold ornaments
- LTV to be maintained through out the tenure of the loan and will be computed against total outstanding including interest
- average of the closing price of 22 carat gold for the preceding 30 days as quote

# Term Loan - GOLD LOAN

- Gold ornaments to be the **approved valuer** of the Bank
- If Period of tenure **exceed 12 months from the date of sanction**
- **Interest will be charged to the account at monthly rests**
- To Complete **detail of inventory in the Security register duly signed by the borrower**

# Cash Credit

- To **finance working capital** requirements
- Requires periodic **renewal** (usually yearly)
- Requires **monthly stock** statement for calculation of **drawing power**
- Requires **monitoring of end use** of funds
- Requires **project report**
- **Yearly visit** and evaluation necessary

# Cash credit - Verification

- Appraisal of Sanction limit
  - Turnover Method 20% of projected sales
  - Traditional Method
  - Based on MPBF calculated on basis of working capital gap
- Verification of drawing power
  - DP is the amount of working capital funds allowed to borrower to draw from the working capital limit allotted to him
  - Calculated on basis of stock statements submitted by the borrower
  - It is DP allowed or Sanction Limit whichever is lower .

# CC - DP Calculation

- $\text{Stock} + \text{Debtors} - \text{creditors} = \text{Working Capital}$
- $\text{Working Capital} - \text{Margin} = \text{Allowed Dp}$
- In some banks Margin for debtors and stock is different
- While calculating Debtors need to remember whether Bill Discounting is given to the said borrower
- Need to check No of days permitted as debtors
- Need to see that constant stock is not there for last 3 months or more which is slow moving stock

## CC- Points For Verification Of Stock Statements

- Stock statements to be in the Bank's **prescribed format**
- Submission of Stock Statement **at prescribed interval**
- Stock statement as **on last date** of the month.
- **Age wise classification** of Sundry Debtors
- **No DP** on book debts against **associate concerns** if stipulated in sanction

## CC- Points For Verification Of Stock Statements

- **Quarterly certification** of book debts by the Statutory Auditors of the borrower.
- Detail of Sundry Creditors provided
- **Stocks purchased under LC to be shown separately**
- **Margin** calculated **correctly**
- Correct. **entry in system**
- **Penal interest** flag for non submission is “ Y”



# CC - Insurance

- See the same for **primary & collateral**
- See **for type of security** like fire, earthquake, burglary, terrorism etc.
- See for **all locations of Stocks** and stock in transit as well
- Also **confirm address** of risk cover on policy
- **Bank's clause** in insurance policy
- **Validity period** to be alive

# CC- Monitoring of accounts

- **Withdrawals from the account** for purchase of material and meeting day to day operational expenses
- See whether any **heavy withdrawal observed**
- See **sufficient credits** are available to cover interest is covered
- Confirm that any **credit is not due to sale of any assets** and unusual credits not related to business activity

# CC- Monitoring of accounts

- Or **Credit from sister concern** and rotation of funds just to arrive at proper report in the system
- Also confirm whether **from related party** .
- **Annual review of accounts – Non renewal for over 180 days amount to slippage of accounts to NPA**

# Bill Discounting

- ‘invoice discounting’ or ‘bills discounting’ or ‘purchase of bills’ are all same
- source of **working capital** finance for the seller of goods on credit.
- Bill discounting is an arrangement whereby the **seller recovers an amount of sales bill from the financial intermediaries before it is due.**

# Bill Discounting

- Bill discounting against **sanctioned limit** of the borrower
- Bills to represent **genuine trade transaction- no accommodation bills**
- Facility to be allowed to **only customer availing regular credit facilities. Walk in customers to be avoided.**
- Bills to be **accompanied by GRs of IBA approved transporters.**

# Bill Discounting

- Bills to be realized on due dates.
- If bills are drawn under LC, ensure that LC is issued through SFMS
- (Structured Financial Messaging System - A secured messaging software developed for inter banks and intra bank applications)

# WCTL

- **Working Capital Term Loan**
- In some Banks this Loan is given
- Is for Actually for **project finance**
- Loan Sanction as per the **stage of the project**
- But repayable in **Installments** as per the recovery
- Always funded on **stage basis on net required Amount.**

# Overdraft

- Normally against FDR or
- Immovable property or
- Against NSC / LIC etc
- Annual renewal if allowed against property
- Renewal on maturity of deposit also.
- No requirement for submission of stock statements / or only once in half year



# OD - Loan Against FDR

- No loans against other bank's deposits as per RBI's guidelines
- No loan against third party deposits if prohibited by Bank's loan policy
- Loan against FDR if in joint name- to be applied and documents to be executed by joint holders
- Prescribed margin maintained
- FDR discharged and bank's lien marked on FDR as well in system
- Correct rate of interest charged

# OD - Loan Against Lic Policies

- LIC Policy to be in the name of the applicant and it is alive
- Surrender value obtained and advance granted on basis of surrender value after keeping prescribed margin
- Up-to-date premium paid
- Policy is assigned in favour of the Bank

# OD - Loan Against Securities

- No loan against partly paid up shares allowed
- Maximum amount of loan against shares to individuals :
  - Rs 10 lacs if held in physical form
  - Rs. 20 lacs if held in dematerialized form
- No loan to be granted to proprietorship concern or a partnership firm against primary security of shares and debentures

# Exports Credit – PreShipment

- Pre-shipment finance refers to the financial assistance provided to the **exporters before actual shipment of goods.**
- Pre-shipment finance is provided to the exporters for the purposes **like purchase of raw materials, their processing and converting into finished goods** and packaging them.

# Export Credits - Pre Shipment (Packing Credit)

- To be released **against LC or confirmed order** from the overseas buyer
- Satisfactory **credit report of overseas buyers** from approved credit available
- Packing credit **utilized for purchasing goods for export purposes**
- **ECGC coverage obtained.**
- ECGC premium to be borne by the borrower.

# Export Credits - Pre Shipment (Packing Credit)

- Packing credit granted for a **maximum period of 270** days with further extension allowed upto 90 days with permission of higher authorities.
- **Reporting to RBI** case Packing Credit **not adjusted within 360 days.**

# Export Credits - Pre Shipment (Packing Credit)

- In case of **over due Packing Credit**, **ECGC to be duly notified**
- **If export does not take place**, interest at commercial rate to be recovered from the date of released.
- **Interest subvention**, if granted, to be **duly claimed**.
- **No interest subvention on overdue packing credits.**
- Monthly stock statements submitted and release restricted to allowable DP
- To be **liquidated out of proceeds of export bills** .
- If liquidated from **inland proceeds**, commercial rate of interest from the date of release to be charged.

# Exports Credit–Post Shipment

- Post-shipment finance may be as “any loan or advance granted or any other credit provided by a bank **to an exporter of goods from India** from the date of extending the credit **after shipment of goods to the date of realization of export proceeds.**”
- post-shipment finance serves as **bridge loan for the period between shipment of goods and the realization of proceeds**



# Export Credits - Post Shipment Credit

- Extended in the form of **discounting of export bills** or advance against export bills for collection.
- **Satisfactory credit report** of overseas buyer available from the approved rating agency
- **No existing overdue export bills** while discounting new bill.
- **Fresh bills not to be discounted to adjust old overdue bills**
- Interest **subvention claimed** .
- **No interest subvention on overdue bills**

# Export Credits - Post Shipment Credit

- Bills liquidated from **export proceeds**
- **ECGC coverage available**. Premium on post shipment to be borne by the bank.
- In case of **extension of bills**, ECGC to be duly **notified**.
- Timely submission of **claim to ECGC in case of default by the borrower**.
- Bills accompanied by export documents including **shipping bill, bill of lading, invoice**
- Authenticity of Shipping Bill issued by the customs verified from the site “[Icegate.gov.in](http://Icegate.gov.in)”

# Imports Credit–Capital Goods /RM OR Letter of Comfort

- **Buyer credit** is a short **term credit** available to an importer (buyer) **from overseas lenders** such as **banks and other financial** institution for goods they are importing.
- The overseas banks usually lend the importer (buyer) **based on the letter of comfort** (a bank **guarantee**) issued by the **importer's bank**.
- For this service the importer's bank or buyer's **credit consultant charges a fee called an arrangement fee**.

# Imports Credit–Capital Goods /RM OR Letter of Comfort

- Examine **Application** form carefully.
- Check whether it is **for Raw Material or Capital Goods**
- Check the **terms of sanction by intermediary foreign bank**
- Check the **documentation**
- **Interest Payments** and Repayment of Loan
- **Income booking** by the Bank
- **Settlement / Roll over of LoC**

# PM – Mudra Yojana

- **MUDRA** is a financial **initiative by PM Narendra Modi**, created in order to facilitate the micro units and provide them sufficient funds in order to develop
- **Small businesses are often unable to avail loans** from banks because of lack of collateral and insufficient funds to pay off the interest.
- There are **almost 577 crore small businesses** currently functioning in India.
- According to the PM, helping these businesses grow would in turn **lead to the development** of the Indian economy.

# PM – Mudra Yojana

- To lay down **policy guidelines to finance micro/small** enterprises
- To get all Micro Finance Institutions and entities **registered and regulate the same.**
- To help small businesses **grow and develop their enterprise further.**
- To **assist lower income groups** in setting up and developing their business.
- To help set up responsible financial practices in order to **prevent over borrowing for lower income entrepreneurs.**
- To help create **easy access to finance** for the unbanked and also help lower the cost of finance.
- To give SC/ST preference in lending.
- To regulate all Micro Finance Institutions dealing with **manufacturing, service and trading.**

## all small businesses and enterprises in need of finance are eligible for a loan.

Businesses of proprietary as well as of partnership nature are eligible. Apart from this, all small business and manufacturing units like food services, vegetables and fruit vendors, hair cutting saloon, beauty parlours, transportation services, repair shops, self help groups, hawkers, artisans and various other professionals and service providers working at lower level are eligible to avail loans of up to Rs.10 lakh.

# Mudra Loan – Documents

- Self attested proof of identity along with the loan applicant's **2 passport size photographs**.
- **Quotation of items and machinery** to be purchased.
- **Details of suppliers** and machineries as well as other items to be purchased.
- Identity of ownership of business and business **address along with copies of necessary licences** and certificates.
- Proof of **category life SC/ST and** others if any.



# Mudra Loan Features

- First off, no necessary collateral or
- loan application fee is required to place an application for loan.
- Apart from this, another key feature of this scheme is that its interest rate is only 1%.

# Non Fund based

# Letter Of Credit

- An **undertaking** from the **Bank** on behalf of the **customer (buyer) to the seller** of the goods to pay the contracted amount.
- In case the **buyer fails to pay** on the stipulated date , **Known as LC devolvement**
- I.e default by the customer.

# Letter of credit

- Issue of LCs through SFMS
- Satisfactory credit report of the beneficiary from the approved rating agency available
- LCs cover goods in which the customer deals
- Applicable commission charged
- LC within the sanctioned limit. Prescribed margin maintained.
- Goods transported through IBA approved transporters
- Expired LC reversed
- No fresh LC in case of existing devolved LC

# Bank Guarantee

- **Financial** : to meet financial obligations (like security deposits)
- **Performance** : To meet contractual obligations (like satisfactory project completion)
- **Binding on the issuing Bank to pay** to the beneficiary the guarantee amount in **case of default by the customer.**
- Exercise of the right by the beneficiary known as **Invocation** of guarantee.

# Bank guarantee

- Issue of Bank Guarantee **through SFMS**
- Bank guarantee issued **within the sanctioned** limit
- Prescribed **margin maintained**
- Application **commission** including commission for claim period recovered
- In case of **Performance Guarantee**, periodical **progress report from competent engineer obtained**
- **Expired** Bank Guarantees **reversed**

# Bank Guarantees RBI Guidelines

- Bank Guarantees **exceeding Rs. 50,000/-** to be signed **by 2 branch** officials jointly.
- Bank Guarantees to Stock Exchange on share brokers- maintenance of minimum 50% margin out of which minimum 25% cash margin to be maintained
- **Immediate payment of invoked Bank guarantees**

# Co-acceptance Of Bill.

- **Bill of exchange** drawn by the supplier on the buyer of goods (customer of the Bank) **co accepted by Bank.**
- Acts as **a guarantee by the Bank** to the supplier to make payment in case of non payment by the buyer



# Co-acceptance of bills

- Represent **genuine trade bills**
- Co acceptance of **bills of Rs. 10,000/- or more** to be **signed by 2 branch** officials jointly
- Facility to **customers already enjoying credit** facilities from the Bank

# Monitoring

# Monitoring

- All terms of **sanction duly complied** with
- **Disbursement** as per the terms of sanction.
- Prescribed **margin** obtained.
- **Rate of interest** correctly fed in system
- Applicable **charges recovered** like processing fee , valuation charges , legal fees , any other if applicable .
- **Overdrawing's in the account need based**, properly reported, within discretionary power, adjusted in time

# Monitoring

- **Primary securities** created and necessary bills held as **proof of purchase**
- **Post disbursement inspection** made
- Submission of **stock statement** at prescribed interval, **calculation of DP** as per lending policy
- **Stock audit** in applicable cases
- **Balance confirmation** letter at periodic intervals

# Monitoring

- Monitoring Of Operations In Account .
- Prompt Action In Case Of Early Warning Signals
- Including Low Turnover,
- Frequent Excess,
- Frequent Returning Of Cheques,
- Huge Cash Deposits And Withdrawals,
- Frequent LC Devolvement

# Monitoring

- Submission of statements of financial performance (QIS etc)
- Renewal of Insurance of primary and collateral securities
- Submission of NO dues statutory statement certified by CA for each year .
- Renewal of working capital limits on annual basis

# Types Of Securities And Charges:

# Types Of Securities And Charges:

- **Immovable properties** like house properties, plots of land; leaseholds are the most common.
- Amongst **movables**, shares, insurance policies, debentures, book debts, bank deposits, stock in trade etc., are a few examples.
- Whereas, an immovable property is **mortgaged**, the movables are **pledged or hypothecated**,
- In the case of companies **all are charged by way of a floating charge**.



# TYPES OF CHARGES: PLEDGE

- Under **section 172 of Indian Contract Act** pledge means “**Bailment of Goods as a**
- security for repayment of a debt or performance of a promise”.
- Important **features** of Pledge are –
- Actual or **constructive delivery** of security is given to the Bank.
- **Ownership remains** with bailers (**Borrower**).
- **Liable to returned** after fulfilment of promise or repayment of loan amount.
- **Disposal possible only after default** and giving due notice to the bailer (Borrower).
- A common example of pledge is **gold ornaments**, which are pledged with the Bank as a
- security against which Gold Loan is given.

# TYPES OF CHARGES: HYPOTHECATION

- It is **not defined under any law**. Extended idea of pledge.
- It relates to **goods/commodities, movable** machinery, vehicles, book-debts.
- **Ownership** remains with **the borrower**.
- **Possession is also** with the borrower.
- **Symbolic/constructive possession** with creditor (Bank).
- It creates **an equitable charge**.
- Hypothecation Agreement gives Banker a **right to take possession of hypothecated goods, machines**.
- Examples of Hypothecation charge are hypothecation of **stocks, receivables, vehicles etc.**

# TYPES OF CHARGES: ASSIGNMENTS

- It is covered under **section 130 of Transfer of Property Act 1882.**
- Only actionable claims can be assigned. (**LIC policies, Supply, Bills, Book Debts etc.**)
- **Transfer of existing/future debts, right or property** belonging to a person in favour of another person.
- Assignee gets **absolute right over money/debts** assigned to in his favour or to him.
- **Assignee has priority over other's claim.**

# TYPES OF CHARGES : SET OFF

- “Right of a Banker to appropriate the credit balance in one account of the customer towards sums due by customer to the Banker in another account in order to arrive at the net sum due”.
- Can be **executed in the absence of any contract** to the contrary.
- **Account** should be in **identical names** of the same person.
- **All branches** of the Bank can be treated as one.
- **Debts** should be **due immediately**.
- Debts should be **recoverable**.
- Right of set-off is applicable to **Banker alone and not to the customer**.
- Banker has a **priority over other attachment orders**.

# TYPES OF CHARGES : BANKER'S LIEN

- “A lien is a right of the creditor in possession of goods, securities or any other asset belonging to the debtor to retain them until the liability is discharged, provided that there is no contract expressed or implied to the contrary”.
- A lien confers only the right to the creditor to retain goods, until debt is discharged, but does not give right of sale.
- No agreement is necessary.
- The debt should arise out of some service rendered or money spent on the goods/securities on which the right of lien is to be exercised.
- Best examples of lien are Goldsmith's, Tailor's, Carrier's and Watch Repairer's etc.

# TYPES OF CHARGES : MORTGAGE

- **Transfer of Property Act 1882 defines Mortgage as: -**
- “Transfer of an interest in specific **immovable property for the purpose of securing the payment of money** advanced by way of loan, on existing or future debt or the performance of an engagement which may give rise to pecuniary liability”.
- Thus the **essentials of mortgage are:**
- **Mortgagor** must be the **owner** or a person having interest in immovable property.
- Mortgagor must have **a contractual capacity.**
- Property must be a **specific immovable property.**
- Purpose **is to secure the loan repayment.**

# TYPES OF MORTGAGES

- **Simple Mortgage**
- It is like a charge.
- Mortgagee does **not enjoy right of foreclosure**, right to enter into possession or even sale without court's intervention.
- Can be **created anywhere, by any person, anywhere for any property.**
- **Needs to be registered** with Sub-Registrar of Assurances.
- **Usufructuary Mortgage**
- Confers on mortgagee a **right of possession** of the property **and right to enjoy rents/profits**, until the debt is paid.
- **No rights to sale.**

# TYPES OF MORTGAGES

- **English Mortgage Or Registered Mortgage**
- Property is transferred absolutely to the mortgagee.
- Mortgagor agrees to bind himself to repay the mortgage money on a certain day.
- Provision to reconvey the property to the mortgagor on payment on due date.
- Mortgagee has a right of private sale (subject to restrictions under section 69 of Transfer of Property Act 1882)
- Registration compulsory.



# TYPES OF MORTGAGES

- **Mortgage by Deposit of Title Deeds (Equitable Mortgage)**
- **No registration** required.
- Created by **depositing Original Title Deeds** of the Property by owner with the Bank.
- Can be created at specific centres only.
- **Attracts stamp duty.**
- **No right to enter into possession.**
- **No right of appointment of receiver** is available.

# TYPES OF MORTGAGES

- Persons Not Entitled to do the Mortgage :-
- Under Section 7 of Transfer of Property Act, any **person competent to contract can transfer property.**
- Therefore a **minor; insolvent, insane, idiot,** alien enemy; felon, drunkard cannot execute a mortgage deed.

# TYPES OF MORTGAGES Case of Company Property

- A mortgage by a **company** should be **duly authorised by a resolution according to the Articles of Association** and transaction should not be ultra vires the Memorandum of Association.
- The charge thus created shall be **registered with the Registrar of Companies.**
- Mortgage affected by the **promoters of a company before its incorporation is invalid.** It **cannot be ratified after** incorporation because the principal was not in existence at the time of the transaction by an agent.

# TYPES OF MORTGAGES Case of Company Property

- In the event of a default, the mortgagee is entitled to file a suit for Foreclosure or a Suit for Sale as per the terms of the Mortgage in terms in the Mortgage deed.
- Banks being financial institutions file suits only for sale and for money.

# Other Related Issues

# Adhoc Limits / Temporary limits

- **Application** from the borrower
- For **genuine** reasons
- All the relevant **supportings submitted** by the borrower
- Corresponding **changes made in the security and loan agreements**
- Appropriate **authority to sanction**
- Given for a **specified period and adjusted** within the said time
- Should **not be accommodation** facility

# Transfer of borrower accounts from one bank to another

- Banks should put in place a **Board approved policy** with regard to take-over of accounts from another bank.
- **authority levels for sanction of takeover,**
- **reporting of takeover** to higher authorities,  
monitoring mechanism
- credit audit
- examination of **staff accountability** especially in case of **quick mortality**
- **periodic review of taken** over accounts at Board / Board Committee level, Top Management level, etc.

# Transfer of borrower accounts from one bank to another

- obtain **necessary credit information** from the transferor bank as per the format prescribed in Annex II of RBI circular DBOD.No.BP.BC.94/08.12.001/2008-09 dated December 8, 2008
- The transferor bank, on receipt of a request from the transferee bank, **should share necessary credit information as per the prescribed format at the earliest**



## 2.3.17 Lending under Consortium Banking Arrangement

- Various restrictions in consortium finance, withdrawn by Reserve Bank of India in October 1996
- Central Vigilance Commission, shown concern due to various frauds in such type of lending because of lack of sharing of information
- Matter has examined in consultation with the Indian Banks Association

## 2.3.17 Lending under Consortium Banking Arrangement

- DBOD.No.BP.BC.94/08.12.001/2008-09 dated December 8, 2008 the **banks are encouraged to strengthen their information back-up** about the borrowers enjoying credit facilities from multiple banks as under:
- **obtain declaration from the borrowers** about the credit **facilities already enjoyed** by them from **other banks** in the format prescribed in Annex 6.
- **exchange information about the conduct of the borrowers' accounts**

## 2.3.17 Lending under Consortium Banking Arrangement

- Obtain regular certification by a professional, preferably a Company Secretary, Chartered Accountant or Cost Accountant, regarding compliance of various statutory Dues
- greater use of credit reports available from a credit information company
- suitable clauses in the loan agreements so as to address confidentiality issues.

# Consortium Arrangement

- Number of lending banks is **more than one**.
- The **lending banks form a** formal consortium.
- Main features:
  - Bank with the **largest exposure is the lead bank**
  - **Common set of loan documents**, which is obtained by the lead bank on behalf of all the consortium member banks.
  - **Lead bank is responsible** for overall **monitoring**.
  - The **securities are shared by the member banks in an agreed proportion** based on their exposures.
  - Borrower maintains direct business relationship with all the member banks of consortium

# Revenue Leakage

# Revenue leakage - Charges

- **Processing Fee:**
  - Non charging of Processing fee
  - Non Charging of Processing fee for broken period
  - Non Charging of Processing fee on non fund based limits
- **Service Charges:**
  - Non charging of commitment charges
  - Non Charging of annual lead bank charges

# Revenue leakage - Interest

- **Non Charging** of interest in the account
- **Reversal of penal interest** for non renewal due to back dated history change
- Loan against FDR- **Increase in rate of interest of FDR** without corresponding change in the rate of interest of the Loan account
- **Non charging of penal interest for non submission of stock statement**, non renewal of account
- Non charging for penal interest for non **compliance of terms of sanction like failure to obtain external rating**

# Revenue leakage - Interest

- Continuation of **charging concessional rate of interest/applicable charges** after the lapse of sanction
- Non charging **commercial rate of interest** from the date of release in export limits where export has not taken place
- Charging of **rate of interest lower than** applicable rate of interest
- Continuation of charging **simple interest instead of compounded interest in case of education loans** where repayment has started



# SARFAESI

- Governed under **Securitization and Reconstruction of Financial Assets and enforcement of Security Interest Act 2002** grants significant **power to banks to** possess the securities of the **defaulting borrower and recover the dues.**

# SARFAESI

- **Pre-conditions** The Act stipulates four conditions for enforcing the rights by a creditor.
- The **debt is secured**
- The debt has been **classified as an NPA** by the banks
- The **outstanding dues** are one lakh and above and more than **20% of the principal loan amount** and interest there on.
- The security to be enforced is **not an Agricultural land**.

# SARFAESI

- All actions to be taken by an authorized official not below the rank of Chief Manager
- 60 days demand notice under Section 13 (2) of the Act
- In case of any objection, reply to be given within 15 days. In case of non reply , further proceedings against the notice can not be taken
- After taking possession, publication in 2 newspaper within 7 days of taking possession
- After the expiry of 60 days, possession by the Bank under section 13 (4) of the Act. Before possession, borrower and guarantor to be informed
- Fresh valuation of property by the approved valuer to fix reserve price
- 30 days notice to the borrower for sale of property
- Sale can be made through tender or auction

# Wilful defaulter

- Defined under RBI CIRCULAR NO CID.BC.22/20.16.003/2015-16 dated July 1, 2015
- Any borrower with **sanctioned limit above Rs 25 lacs on the occurrence of following events :**
- Default in repayment of dues even when it **has the capacity to honour the obligations**
- **Diversion** of funds
- **Siphoned** off the funds
- **Removable** of movable or immovable property **without the knowledge of the Bank**

# CASE STUDIES FOR FRAUDS/SERIOUS IRREGULARITIES

- Car Loan - Opening of bank accounts in the name of dealers and encashing the DDs
- Loan Against FDR - Obtaining loan against FDRs by fraudulently executing loan documents
- Granting of loan against non-existent FDRs
- Unauthorized opening of loan accounts and release of funds to related parties
- Unavailed limit in housing loan transferred to related parties accounts
- Opening of accommodation inland LC issued in favour of related parties
- LC devolved and funds not paid
- Bills discounted under LC of other Bank which later turned out to be fake
- Loan against fake title deed of properties

# CASE STUDIES FOR FRAUDS/SERIOUS IRREGULARITIES

- Sanction without proper applications and credit appraisal
- Sanction made beyond discretionary power and non-reporting of the same to the appropriate authority
- Unauthorised release of securities
- Charging of same security to different Banks and for different facilities
- Diversion of funds - to other concerns
- Fraud risk relating to controls – Debits in income

# CASE STUDIES FOR FRAUDS/SERIOUS IRREGULARITIES

- Accommodation of excess drawing to customers.
- Frequent overdrawing beyond limits
- Bouncing of cheques due to insufficient funds
- Frequent issue of stop payment instructions.
- Cheques deposited and not honored.
- TOD for major part of the month, adjusted at end
- Non submission of FS in time – non renewal
- Existence of overdue bills, devolved L\C etc...
- Delay / Non Submission of Stock / Book debts statement.
- POTENTIAL NPA'S(Early Alert/Special Mention)

# CASE STUDIES FOR FRAUDS/SERIOUS IRREGULARITIES

- Manual intervention by the Branch whereby the repayment schedule in term loans is changed – ballooning effect – adding moratorium – changing the rate of interest – master data not tallying with the sanctioned terms
- Same customer having 2 or more CIF nos. in system to avoid NPA tagging in all accounts
- Passing entries in the accounts not availing limits to the accounts which are slipping to NPA
- Parking the devolved LCs in separate accounts
- System not flagging NPA accounts
- Income being accounted in NPA accounts



# Reporting

- Usually as per the formats of individual banks
- Auditors can insert their comments freely in the reports at the respective areas or give separate paragraphs highlighting their observations
- Report to be discussed with the Branch before final submission
- Be precise and use simple language
- Get acquainted with the online audit software packages and the reporting formats – daily logging in as it marks the presence of auditors at the Branches
- Stick to the due dates or else possibility of fees being cut as penalty
- Serious observations to be immediately reported to higher authorities

Questions ???

# Contact

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**Thank You**