Term paper on idlc

Term paper on Functions oF credit risk management in non Banking Financial institutions (nBFi) in Bangladesh A study on IDLCFinanceLimited Submitted to: Submitted By: Date of Submission: Letter of Transmittal_______________________ 23rd December 2013 Sh University Subject: Submission of term paper of BBA Programme Dear Madam, It is my great pleasure to submit the term paper on " Functions of Credit Risk management in Non Banking Financial Institutions (NBFI) in Bangladesh, A study on IDLC Finance Ltd " which is a part of BBA Programme to you for your consideration.

I made sincere efforts to study related materials, documents, observe operations performed in IDLC Finance Limited and examine relevant records for preparation of the report. Within the time limit, I have tried my best to compile the pertinent information as comprehensively as possible and if you need any further information, I will be glad to assist you. Your most obident pupil, Acknowledgement ____________________________

At first I would like to thank my honorableinternshipsupervisor from BRAC Business School (BBS), BRAC University, SharminShabnam Rahman for providing me such an opportunity to prepare an Internship Report on " Functions of Credit Risk management in Non Banking Financial Institutions (NBFI) in Bangladesh, A study on IDLC Finance Ltd ". Without her helpful guidance, the completion of this project was unthinkable. I would like to place my gratitude to the HR of IDLC Finance Limited to enable me to complete my internship in their esteemed organization. Very special thanks goes to Mr.

M. Jamal Uddin, Deputy General Manager & Head of Corporate and Structured Finance Division, IDLC Finance Limited & Mr. AlamIftekhar Chowdhury, Manager Corporate Division, IDLC Finance Limited, for helping me in all phase of the internship process. Their overwhelming support for my internship gave me the inspiration to do a better report. During my preparation of the project work I have come to very supportive touch of different individuals (respondents from IDLC Finance Limited) & friends who lend their ideas, time & caring guidance to amplify the report’s contents.

I want to convey my heartiest gratitude to them for their valuable responses. Executive Summary_______________________ The non-bank financial institutions (NBFIs) constitute a rapidly growing segment of the financial system in Bangladesh. The NBFIs have been contributing toward increasing both the quality and quantity of financial services and thus mitigating the lapses of existing financial intermediation to meet the growing needs of different types of investment in the country. Today all NBFIs are playing a vital role for the growth of the nation’s economy with the best of their ability.

During the world recession period NBFIs in Bangladesh act in a stringent manner so that their financial systems as well as the economy do not collapse. 29 NBFIs are now contributing to the growth of national economy. IDLC Finance Ltd as a leading and pioneer NBFI started their operation in 1986 and still they are dominating the NBFI sector as well as contributing to the prosper of economic development. Their success in this industry has inspired others to invest their capital in a profitable way.

As major business of all NBFIs are providing lease facilities to the business along with various types of loan to individual and organizations therefore risk is associated with each and every product they are offering. To minimize this risk every institution has its own risk management policies. A number of actions are taken so that risk associated to their investment can be minimized. This report is emphasizes credit risk management in NBFIs in Bangladesh. In this regard IDLC Finance Limited has been taken as the sample organization, its, services, rules and regulation, corporate governance is also taken into consideration.

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 1. 1INTRODUCTION The development of financial market has been receiving heightened attention from the policy-makers in recent years. One explanation lies in the fundamental shift of development strategy reflected in the nearly universal embrace of the private sector as an engine of economic growth. The governments in both developed and developing countries, the international financial institutions which exert tremendous influence on the policy-making apparatus of developing countries and, to a great extent, the intelligentsia have all joined together as ardent advocates of private entrepreneurship.

IDLC Finance Ltd, a leading financial institution of the country achieved significant growth in all areas of business up to 3rd quarter of the year 2009. IDLC began its operation in 1985 as the first leasing company in Bangladesh. In 1995, IDLC was licensed as a Financial Institution by the country's central bank and during the last two decades, the company has grown in tandem with the country's growing economy. The company's wide array of products and services range from retail products, such as home and ar loans, corporate and SME products including lease and term loans, structured finance services ranging from syndications to capital restructuring and capital market services. The company also strengthened its presence in the country's growing stock market with launching a subsidiary-IDLC Securities Limited-which is offering full-fledged brokerage service for retail and institutional clients. . 1. 3 OBJECTIVES OF THE REPORT The main objective of the study is to get a definite idea about how CRM plays a vital role in managing the risk associated with each and every product and services of IDLC Finance Limited.

Furthermore, the orientation is very useful to detect whether the theoretical knowledge matches with real life scenario or not. Though the title " Functions of Credit Risk management in Non Banking Financial Institutions (NBFI) in Bangladesh, A study on IDLC Finance Ltd” very lengthy area, the specific objectives are as follows: 1. To know the necessity of Credit Risk Management. 2. To learn about the whole CRM procedure. 3. To know the decision making process of CRM. 4. To know the functions of Special Asset Management part of CRM 5.

To know about the probable modification can be done in the whole CRM process 6. 1. 4 METHODOLOGY OF THE STU Analysis has been made on the basis of the objectives mentioned before in the context of " Functions of Credit Risk management in Non Banking Financial Institutions (NBFI) in Bangladesh, A study on IDLC Finance Ltd” The paper will be written on the basis of information collected fromprimary and secondarysources. (i) Primary Data; Discussion with the respective organization's officials. (ii) For the completion of the present study, secondary data has been collected.

The main sources of secondary data are: * Annual Report of IDLC Finance Limited. ? Website of IDLC Finance Limited. * Data from published reports of SEC, DSE * Different Books, Journals, Periodicals, News Papers etc. To make a report various aspects and experiences are needed. But I have faced some barriers for making a complete and perfect report. These barriers or limitations, which hinder my work, are as follows: * Difficulty in accessing data of its internal operations. * Non-Availability of some preceding and latest data. * Some information was withheld to retain the confidentiality of the organization.

I was placed for only around 3 months of time ; working like a regular employee hindered the opportunity to put the effort for the study. The time p was not sufficient enough to learn all the activities of the organization properly. Therefore, it was very difficult to carry out the whole analysis. 1. 6 STRUCTURE OF THE REPORT The report has two main parts: Part One: This is basically introductory part, the objective and scope of the study, limitations, and research methodology has been highlighted. Brief Introduction of IDLC

Finance Limited, its product and service, organizational structure, performance, etc are presented.

Part Two: Products of NBFIs for which Credit Risk Management has become a key operational tool, how it performs its overall risk analysis and on the basis of the analysis identification of the ways of reducing the risk, thus maintains the core interest of the business. This part also contains the conclusion, reference ; appendix of the report. 2. 0 The Company 2. 1 ILDC FINANCE LIMITED IDLC Finance Ltd commenced its journey, in 1985, as the first leasing company of the country with multinational collaboration and the lead sponsorship of the International Finance Corporation (IFC) of The World Bank Group.

Technical assistance was provided by Korean Development Leasing Corporation (KDLC), the largest leasing company of the Republic of South Korea. The unique institutional shareholding structure comprising mostly of financial institutions helps the company to constantly develop through sharing of experience and professional approach at the highest policy making level. IDLC offers a diverse array of financial services and solutions to institutional and individual clients to meet their diverse and unique requirements.

The product offerings include Lease Finance, Term Finance, Real Estate Finance, Short Term Finance, Corporate Finance, Merchant Banking, Term Deposit Schemes, Debentures and Corporate Advisory Services. The company has authorized capital of Taka 1, 000, 000, 000 (10, 000, 000 shares of Taka 100 each) and paid up capital of Taka 250, 000, 000 (2, 500, 000 ordinary shares of Taka 100 each). IDLC has also established two wholly owned subsidiaries, IDLC Securities Limited and I, Cons Limited to provide customers with security brokerage solutions and IT solutions, respectively. 2. SHAREHOLDING STRUCTURE IDLC was incorporated in the year 1985 as a joint venture public limited company among five foreign and three local financial institutions. Now there are no foreign investors the present Shareholding Structure of IDLC Finance Ltd is given bellow: SL. NO. | NAME OF SHAREHOLDERS | % | | Sponsors/Directors:| | 1 | The City Bank Ltd. | 29. 70 | 2 | SadharanBima Corporation | 7. 62 | 3 | IPDC of Bangladesh Ltd. | 0. 0002 | | Sub-Total | 37. 33 | | GENERAL| | 4 | Institutions : | | | Mercantile Bank Ltd. 7. 50 | | Reliance Insurance Co. Ltd. | 7. 00 | | Eskayef Bangladesh Ltd. | 8. 00 | | BD Lamps | 1. 32 | | Transcraft Ltd. | 4. 01 | | Eastern Bank Limited | 6. 00 | | Phonix Finance | 1. 00 | | PartexBaverage| 0. 86 | | Marina Apparels | 1. 00 | | ICB | 2. 32 | | Dhaka Stock Exchange Ltd. | 0. 95 | | One Bank Ltd. | 0. 5 | | Star Particle Board | 0. 60 | | Bangladesh Finance ; Invest. | 0. 88 | | Other institutions | 6. 92 | | Sub total | 49. 21 | 5 | Individuals : | | | General Public(Individuals) | 13. 45 | | Mr. A. K. M. Shaheed Reza, Director nominated by | | | Mercantile Bank Ltd. | 0. 017 | | Sub total | 13. 47 | | Total Holdings | 100. 00 | 2. 3 COMPANY CHRONICLE May 23, 1985 | Incorporation of the Company | February 22, 1986 | Commencement of leasing business |

October 1, 1990 | Establishment of branch in Chittagong, the main port city | March 20, 1993 | Listed in Dhaka Stock Exchange | February 7, 1995 | Licensed as a Non- Banking Financial Institutions under the Financial Institutions Act, 1993 | November 25, 1996 | Listed on the Chittagong Stock Exchange | May 27, 1997 | Commencement of Home Finance and Short Term Finance Operations | January 22, 1998 | Licensed as a Merchant Banker by the Securities and Exchange Commission | January 15, 1999 | Commencement of Corporate Finance and Merchant Banking Operation | January 29, 2004 | Opening of Gulshan Branch |

November 22, 2004 | Launching of Investment Management Services “ Cap Invest” | February 7, 2005 | Issuance of Securitized Zero Coupon Bonds by IDLC Securitization Trust 2005 | September 18, 2005 | Launching of Local Enterprise Investment Centre(LEIC), a centre established for the development of SMEs with the contribution of the | | CanadianInternational DevelopmentAgency (CIDA) of the Government of Canada | January 2, 2006 | Opening of SME focused branch at Bogra| April 6, 2006 | Opening of Branch at Uttara|

May18, 2006 | Opening Merchant Banking branch in the port city if Chittagong | July 1, 2006 | Relocation of Company’s Registered and Corporate Head Office at own premises at 57, Gulshan Avenue | September 18, 2006 | Commencement of operation of IDLC Securities Limited, a wholly owned subsidiary of IDLC | March 14, 2007 | Launching of Discretionary Portfolio Management Services “ Managed Cap Invest” | August 5, 2007 | Company name changed to IDLC Finance Limited, from Industrial Development Leasing Company of Bangladesh Limited | December 3, 2007 | IDLC Securities Limited Chittagong Branch commenced operation | December 18, 2007 | IDLC Securities Limited DOHS Dhaka Branch opened. | January 6, 2009 | IDLC Finance Limited and IDLC Securities Limited open Sylhet branches | August 09, 2009 | Opening of IDLC Securities Limited, Gulshan Branch | August 26, 2009 | Opening of Gazipur SME Booth | September 09, 2009 | Opening of Imamgonj SME Booth | December 2009 |

Opening of Narayangonj Branch | December 2009 | Opening of Savar Branch | 2. 4 GUIDING PRINCIPLES

IDLC is a multi-product financial institution offering an array of diverse financial services and solutions to institutional and individual clients to meet their diverse and unique requirements. Following are the guiding principles that shape the organizational practice of IDLC Customer first: IDLC has grown with its customers, who are believed to be the center of all actions. As the crux of IDLC’s corporatephilosophy, customer service gets the highest priority. Innovation: IDLC has continuously introduced new financial products for meeting the needs of the entrepreneurs in a complex ; challenging businessenvironment. The concept of innovation is in-built into the workingculture.

Professional Knowledge: IDLC is staffed with qualified professionals and innovative minds in the country. Years of operational experience, large industrial database and competent workforce have gives them unparalleled advantages. Professional ethics: The professional at IDLC maintain the highest degree of financial and business ethics in all transactions with the clients. Over the last two decades, IDLC have put in bets efforts to meet the expectations of the clients and investors. One stop solution: Work at IDLC begins with the idea generation, and then goes on into the feasibility study followed by arrangement of financing to implement the project.

IDLC advises the clients, finance them and even arrange financing for them via different financing modes, namely: lease financing, term loan, bridge loan, syndication, bridge loan, syndication, ordinary shares, preferred shares and debentures. Vision: Become the best performing and most innovative financial solutions provider in the country Mission: Create maximum possible value of all the stakeholders by adhering to the highest ethical standards For the Company: Relentless pursuit of customer satisfaction through delivery of top quality services For the Shareholders: Maximize shareholders' wealth through a sustained return on the investment. For the employees: Provide job satisfaction by making IDLC a center of excellence with opportunity ofcareerdevelopment.

For the society: Contribute to the well-being of the society, in general, by acting as a responsible corporate citizen. Goal: Long term maximization of Stakeholders' value Corporate Philosophy: Discharge the functions with properaccountabilityfor all actions and results and bind to the highest ethical standards 2. 5 ORGANOGRAM THE APEX OF THE ORGANIZATION IS THE BOARD OF DIRECTORS, WITH THE MANAGEMENT COMMITTEE AND MANAGING DIRECTOR IN THE FOLLOWING TIERS. THE BOARD CONSISTS OF THE FOLLOWING DIRECTORS: * Chairman from Reliance Insurance Ltd * Five Directors nominated by The City Bank Limited * One from SadharanBima Corporation (SBC) * One from Transcom Group One From Mercantile Bank Limited * One Independent Director from Monowar Associates ACTIVITIES OF THE BO ARD The Board appoints the Executive Committee (EC), which takes day-to-day decisions on behalf of the company. Every credit proposal has to be approved by the EC for sanction and disbursement. EC is also authorized to observe and review other major day-to-day operational functions including corporate plans, budgets and borrowing activities. The composition of the EC is as follows: a) Four Directors b) Managing Director / Chief Executive Officer and The Company Secretary shall be the Secretary of the Committee ACTIVITIES OF THE MA NAGING DIRECTOR

The Managing Director (MD), appointed by Board, manages the overall organizational activities and also plays the role of the figurehead. ACTIVITIES OF THE DEPUTY MANAGING DIRECTOR The DMD establishes the company’s policies and reviews the operational performance of the company including approval of large credit proposals, major fund procurements, budget and planning and diversification decisions. Diagram: Organ gram of IDLC Finance Limited 2. 6 PRODUCTS AND SERVICES To ensure steady and long term growth as well as to sharpen its competitive edge in a changing and challenging business environment, IDLC always endeavors to diversify into other financial services which have long term prospects.

In 1997, it expanded its range of services by introducing Housing Finance and Short Term Finance, which have broadened its customer base and have contributed significantly to IDLC’s growth and profitability. In early 1999, after getting license of Merchant Banking from Securities and Exchange Commission, IDLC started its operation of underwriting, issue management, corporate financing and other investment banking related services. The products and services are as follows 1. LEASING Assets are leased to clients on predetermined rental basis for a fixed term with a purchase option at the end. 2. TERM LOAN The customers are offered loan facilities for a determined term at a negotiated rate. 3. EQUITY FINANCING

IDLC investsmoneyinto equity of both publicly traded and non-traded companies for dividends and capital gain. 4. INTER CORPORATE DEPO SIT (ICD) This disbursement scheme is offered to clients under two variations:

a) Non- Revolving ICD which consists of single disbursement of funds b) Revolving ICD where multiple disbursements and collections take place 5. WORK ORDER/ PURCHASE ORDER FINANCING The clients are financed against their work order or purchase order on a revolving basis. 6. FACTORING Under this scheme, IDLC finances receivables of supply of goods or delivery of services on credit to help the clients realize the maximum portion of their payment soon after they have made the delivery to the buyer.

The payment is collected from the customers and the balanced amount is re-reimbursed to the clients. 7. SYNDICATION IDLC helps to raise fund for clients with huge financial requirement through syndication and also help them with the documentation, execution and administration of the syndicated finance. 8. SECURITIZATION IDLC sell financial instruments of organizations in local financial market backed by their asset/cash flows such as loan, lease etc. 9. BRIDGE FINANCE: This refers to short-term finance (maturity of not more than 12 months) in anticipation of immediate long term financing such as public issue, private placement, syndication, loan, lease, debenture, etc. 10. CAP INVEST

IDLC maintains a non-discretionary portfolio account for clients where they have absolute power to make investment decisions. the portfolio manager provides margin loan to clients and also prepares the list of securities in which they can invest. 11. DEPOSIT SCHEMES IDLC offer different variety of deposit schemes for clients. * Cumulative Term Deposit * Annual Profit Term Deposit * Monthly Earner Deposit * Double Money Deposit 12. CAR LOAN Term loan are offered to clients for acquiring car, brand new or reconditioned, for their personal use and the ownership is transferred on loan repayment. 13. HOME LOAN IDLC offers loans to purchase apartment to individuals for their personal use 14. REAL ESTATE FINANCE

IDLC finances clients to construct house, renovate and extend house, for office chamber/space for professionals etc. under two different schemes: * Developer's Finance Scheme oCorporate Finance Scheme 15. PRIVATE PLA CEMENT IDLC places the shares/debenture with both domestic and overseas investors (institutions or individuals) on private placement basis. 16. UNDERWRITING IDLC makes a univocal and irrevocable commitment with an issuing company to subscribe to the securities of that company when the existing shareholders or the general public do not subscribe to the securities offered to them. The different types of underwriting offered are: * Initial Public offering (IPO) of common stock, preferred stock, debentures etc. Right Issue oUnderwriting of public securities-loan, lease, debenture 17. ISSUE MANAGEMENT Under this activity, IDLC plan, coordinate and control the entire issue activity of clients and direct other agencies for successful marketing of securities. 18. FINANCIAL A DVISORY SERVICE IDLC help the existing venture or a new venture by providing various advisory services such as corporate counseling, project counseling, capital restructuring, financial engineering etc. 19. MERGERS AND ACQUISIT IO IDLC help clients to search for the right organization, evaluate the concern based on different types of analysis and select the method of m ; a to make it a profitable deal. 20. TRUSTEESHIP MANAGEME NT

We act as trustee for the debenture holders by accepting security created by the company and take action to safeguard their interest and enforce their rights. Table: Product ; Services offered by IDLC Finance Limited 2. 7 DIVISIONS AND DEPARTMENTS The organization includes divisions which mainly deal with the products and services and departments which support in the operating activities. The divisions are the * Corporate * SME * Merchant Banking * Personal Investment * Factoring * Structured Finance * Operations The departments include * Credit Risk Management (CRM) * Treasury * Human Resource * Accounts and Taxation * Administration and PR Operational Risk Management (ORM)/Internal Control Compliance(ICC) * Special Asset Management(SAM) 2. 8 SWOT ANALYSIS The SWOT analysis for IDLC can be described as follows: Strengths 1. Reputation and brand image: IDLC is well-reputed company and has developed a brand image that is recognized by the customers. IDLC is an international joint-venture company and its shareholders have long records of sustainability and reliability in their respective fields. IDLC is one of the esteemed names in financial market of Bangladesh. Since 1985, IDLC has marked its journey through introduction of various innovative products and thus meeting the needs of large corporate clients. 2 .

Product portfolio: IDLC has diverse product portfolio for customers which made them second to none in Non-Banking Financial Industry. 3. Quality Customer Portfolio: IDLC has a Credit Risk Management department of Multinational standard which enables the company to maintain a quality customer portfolio. 4. Human Resources: The Company has competent management team. The over all work force of the company is considered as key resources for the organization. IDLC personnel are motivated, competent, energetic and creative. The company provides utmost support in terms of both technical and moral. 5. Operational efficiency: IDLC provides customized solution to their customers to adjust their need.

The company processes the loan applications quickly and smoothly. The sanction and disbursement of the loans are hassle-free. 6. Employee Empowerment: At IDLC decision-making is free flowing and transparent. Every appraiser is given ample opportunity to exercise his/her creativity in accommodating a customer. Approvers are open for any discussion and sanction is largely based upon recommendation of the appraisers. The open and free flow ofcommunicationensures clarification of any queries in no time--from any level of hierarchy. Reasonable suggestions are not only welcome but are highly appreciated. Effective suggestions by the employees are immediately set for action.

This flexibility has helped IDLC a lot in shaping up its operations into a level of efficiency and to be an excellent performer in case of loan recovery. Weaknesses 1. High Cost of fund: IDLC as any other NBFIs have high cost of fund in comparison to banks. As NBFIs can take deposit for less than one year from any individuals as banks can do, the deposit base of IDLC is not strong enough to reduce the average cost of fund. 2. More Focus on Volume: Although IDLC has department called Credit Risk Management to monitor the asset quality of the company, still the company sometimes for the sake of profit and past relationship provide loans to customers who at the end hamper the portfolio quality of IDLC. 3.

Too Much Diversification: Too much diversification of product and services offering hamper the focus on the core services of the organization. 4. Less People in Liability Marketing: IDLC still employs lesser number of workforces for the aggressive liability marketing in comparison to banks and NBFI like DBH. Opportunities 1. Continuity of Liberalization: Government has continued to liberalize the economy towards more market orientation. This encouraged both local and foreign investors to invest in potential sectors. The privatization plan of government is likely to have positive impact on industrialization. 2. Foreign Investment in Prospective Sectors: In recent days foreign investment in the various prospective sectors has increased phenomenally.

This creates a good opportunity for all financial institutions to enter in the booming new sector. 3. Local banks inefficiency: One of the major reasons for thriving of leasing company in Bangladesh is local banks inefficiency of providing project loan. This phenomenon still persists. Threats 1. Threat from banks: In recent times banks are also entering into leasing business which is generally considered as functions of Non-Banking Financial Institutions. 2. Regularity control of government: The legal framework of Bangladesh is relatively weak. Lack of effective foreclosure laws and manual land recording system creates possibility of forgery and disputes.

This may hinder the loan recovery from the defaulters. 2. 9 PERFORMANCE OF IDLC FINANCE LIMITED 2. 9. 1 CAMEL RATING Rating type | Base | At 31. 12. 08 | Rating | 1. Capital sufficiency C | Reserve should be 25. 00 crore by the end of 30. 06. 06 | 16. 113 Crore| 1(Strong) | 2. Asset Quality A | (Classified loan/lease and other assets)/overdue amount*100 | 6089. 04/153384. 93*100= 3. 97% | 2(Satisfactory) | 3. Management M | Average of C, A, E ; L ratios | (1+2+1+1)/4= 1. 25 | 1(Strong) | 4. Earning Ratio E | (NPAT/TA)*100% (NPAT/TE)*100% | (4063. 72/167085. 65)*100%= 2. 43%

(4063. 72/16113. 12)*100%= 25. 22% | 1(Strong) | 5. Liquidity Ratio L | 1. CRR ; SLR reserve 2.

Interbank dependency 3. Profit | -Reserved -Less dependent -Strong | 1(Strong) | CAMEL | Sum of 5 Ratios/5 | (1+2+1+1+1)/5= 1. 20 | 1(Strong) | CAMEL rating has improved to 1 comparing to the last year 2(Satisfactory) 3. 0 Credit Risk Management 3. 1 WHAT IS RISK? In general Risk can be define as the " Probability or threat of a damage, injury, liability, loss, or other negative occurrence, caused by external or internal vulnerabilities, and which may be neutralized through pre-mediated action. " But in Finance risk is defined concerning some special factors of market and other externalities which can affect an individual or organization's decision.

In Finance risk is defined as " Probability that an actual return on an investment will be lower than the expected return. " Financial risk is divided into the following general categories: (1) Basis risk: Changes in interest rates will cause interest-bearing liabilities (deposits) to re-price at a rate higher than that of the interest-bearing assets (loans). (2) Capital risk: Losses from unrecovered loans will affect the financial institution's capital base and may necessitate floating of a new stock (share) issue. Therefore to reduce this risk Banks, NBFIs, and other organizations take various types of measures so that it can be reduced in a minimal affordable limit. In Banks and NBFIs the core risk is credit risk.

As Banks, NBFIs performs there major operations on providing loan, lease (for NBFIs) therefore there is a chance of default at time of repayment. So to reduce this default risk so that number of default payment does not increase and to forecast this probability with appropriate tools Banks, NBFIs always work on managing their Credit Risk. Several Guideline and standards are prepared so that Credit Risk for individual banks and NBFIs can be reduced. 3. 2 CREDIT RISK Credit risk is the possibility that a borrower or counter party will fail to meet agreed obligations. Globally, more than 50% of total risk elements in banks and FIs are Credit Risk alone. Thus managing credit risk for efficient management of a FI has gradually become the most crucial task.

Credit risk may take the following forms: * In direct lease/term finance: rentals/principal/and or interest amount may not be repaid * In issuance of guarantees: applicant may fail to build up fund for settling claim, if any; * In documentary credits: applicant may fail to retire import documents and many others * In factoring: the bills receivables against which payments were made, may fail to be paid * In treasury operations: the payment or series of payments due from the counter parties under the respective contracts may not be forthcoming or ceases * In securities trading businesses: funds/ securities settlement may not be effected * In cross-border exposure: the availability and free transfer of foreign currency funds may either cease or restrictions may be imposed by the sovereign Credit risk management encompasses identification, measurement, matching mitigations, monitoring and control of the credit risk exposures to ensure hat: * The individuals who take or manage risks clearly understand it * The organization’s Risk exposure is within the limits established by Board of Risk taking Decisions are in line with the business strategy and objectives set by BOD * The expected payoffs compensate the risks taken * Risk taking decisions are explicit and clear * Sufficient capital as a buffer is available to take risk * Directors withrespectto sector, group and country's prevailing situation * Risk taking Decisions are in line with the business strategy and objectives set by BOD 3. 3 CREDIT RISK MANAGEMENT PROCESS Credit risk management process should cover the entire credit cycle starting from the origination of the credit in a financial institution's books to the point the credit is extinguished from the books. It should provide for sound practices in: 1. Credit processing/appraisal; 2. Credit approval/sanction; 3.

Credit documentation; 4. Credit administration; 5. Disbursement; 6. Monitoring and control of individual credits; 7. Monitoring the overall credit portfolio (stresstesting) 8. Credit classification; and 9. Managing problem credits/recovery 3. 3. 1 . CREDIT PORCES SING/APPRAISAL : Credit processing is the stage where all required information on credit is gathered and applications are screened. Credit application forms should be sufficiently detailed to permit gathering of all information needed for credit assessment at the outset. In this connection, NBFIs should have a checklist to ensure that all required information is, in fact, collected.

NBFIs should set out pre-qualification screening criteria, which would act as a guide for their officers to determine the types of credit that are acceptable. For instance, the criteria may include rejecting applications from blacklisted customers. These criteria would help institutions avoid processing and screening applications that would be later rejected. Moreover, all credits should be for legitimate purposes and adequate processes should be established to ensure that financial institutions are not used for fraudulent activities or activities that are prohibited by law or are of such nature that if permitted would contravene the provisions of law. Institutions must not expose themselves to reputational risk associated with granting credit to customers of questionable repute and integrity.

The next stage to credit screening is credit appraisal where the financial institution assesses the customer's ability to meet his obligations. Institutions should establish well designed credit appraisal criteria to ensure that facilities are granted only to creditworthy customers who can make repayments from reasonably determinable sources of cash flow on a timely basis. Financial institutions usually require collateral or guarantees in support of a credit in order to mitigate risk. It must be recognized that collateral and guarantees are merely instruments of risk mitigation. They are, by no means, substitutes for a customer's ability to generate sufficient cash flows to honor his contractual repayment obligations.

Collateral and guarantees cannot obviate or minimize the need for a comprehensive assessment of the customer's ability to observe repayment schedule nor should they be allowed to compensate for insufficient information from the customer. Care should be taken that working capital financing is not based entirely on the existence of collateral or guarantees. Such financing must be supported by a proper analysis of projected levels of sales and cost of sales, prudential working capital ratio, past experience of working capital financing, and contributions to such capital by the borrower itself. Financial institutions must have a policy for valuing collateral, taking into account the requirements of the Bangladesh Bank guidelinesdealing with the matter. Such a policy shall, mong other things, provide for acceptability of various forms of collateral, their periodic valuation, process for ensuring their continuing legal enforceability and realization value. In the case of loan syndication, a participating financial institution should have a policy to ensure that it does not place undue reliance on the credit risk analysis carried out by the lead underwriter. The institution must carry out its own due diligence, including credit risk analysis, and an assessment of the terms and conditions of the syndication. The appraisal criteria will of necessity vary between corporate credit applicants and personal credit customers. Corporate credit applicants must provide audited financial statements in support of their applications.

As a general rule, the appraisal criteria will focus on: * Amount and purpose of facilities and sources of repayment; * Integrity and reputation of the applicant as well as his legal capacity to assume the credit obligation; * Risk profile of the borrower and the sensitivity of the applicable industry sector to economic fluctuations; * Performance of the borrower in any credit previously granted by the financial institution, and other institutions, in which case a credit report should be sought from them; * The borrower's capacity to repay based on his business plan, if relevant, and projected cash flows using different scenarios; * Cumulative exposure of the borrower to different institutions; * Physical inspection of the borrower's business premises as well as the facility that is the subject of the proposed financing; * Borrower's business expertise; Adequacy and enforceability of collateral or guarantees, taking into account the existence of any previous charges of other institutions on the collateral; * Current and forecast operating environment of the borrower; * Background information on shareholders, directors and beneficial owners for corporate customers; and * Management capacity of corporate customers. 3. 3. 2 . CREDIT - APPROVAL/SANCTION A financial institution must have some written guidelines on the credit approval process and the approval authorities of individuals or committees as well as the basis of those decisions. Approval authorities should be sanctioned by the board of directors. Approval authorities will cover new credit approvals, renewals of existing credits, and changes in terms and conditions of previously approved credits, particularly credit restructuring, all of which should be fully documented and recorded.

Prudent credit practice requires that persons empowered with the credit approval authority should not also have the customer relationshipresponsibility. Approval authorities of individuals should be commensurate to their positions within management ranks as well as their expertise. Depending on the nature and size of credit, it would be prudent to require approval of two officers on a credit application, in accordance with the Board’s policy. The approval process should be based on a system of checks and balances. Some approval authorities will be reserved for the credit committee in view of the size and complexity of the credit transaction.

3. 3. 3 CREDIT DOCUMEN TATION

Documentation is an essential part of the credit process and is required for each phase of the credit cycle, including credit application, credit analysis, credit approval, credit monitoring, and collateral valuation, and impairment recognition, foreclosure of impaired loan and realization of security. The format of credit files must be standardized and files neatly maintained with an appropriate system of cross-indexing to facilitate review and follow-up. Documentation establishes the relationship between the financial institution and the borrower and forms the basis for any legal action in a court of law.

Institutions must ensure that contractual agreements with their borrowers are vetted by their legal advisers.

Credit applications must be documented regardless of their approval or rejection. For security reasons, financial institutions need to consider keeping the copies of critical documents (i. e. , those of legal value, facility letters, and signed loan agreements) in credit files while retaining the originals in more secure custody. Credit files should also be stored in fire-proof cabinets and should not be removed from the institution's premises. 3. 3. 4 CREDIT ADMINIS TRATION Financial institutions must ensure that their credit portfolio is properly administered, that is, loan agreements are duly prepared, renewal notices are sent systematically and credit files are regularly updated.

An institution may allocate its credit administration function to a separate department or to designated individuals in credit operations, depending on the size and complexity of its credit portfolio. A financial institution’s credit administration function should, as a minimum, ensure that: * Credit files are neatly organized, cross-indexed, and their removal from the premises is not permitted; * The borrower has registered the required insurance policy in favour of the bank and is regularly paying the premiums; * The borrower is making timely repayments of lease rents in respect of charged leasehold properties; * Credit facilities are disbursed only after all the contractual terms and conditions have been met and all the required documents have been received; * Collateral value is regularly monitored; The borrower is making timely repayments on interest, principal and any agreed to fees and commissions; * Information provided to management is both accurate and timely; * Funds disbursed under the credit agreement are, in fact, used for the purpose for which they were granted; * " Back office" operations are properly controlled; * The established policies and procedures as well as relevant laws and regulations are complied with; and On-site inspection visits of the borrower's business are regularly conducted and assessments documented 3. 3. 5 DISBURSEMENT Once the credit is approved, the customer should be advised of the terms and conditions of the credit by way of a letter of offer. The duplicate of this letter should be duly signed and returned to the institution by the customer.

The facility disbursement process should start only upon receipt of this letter and should involve, inter alia, the completion of formalities regarding documentation, the registration of collateral, insurance cover in the institution's favor and the vetting of documents by a legal expert. Under no circumstances shall funds be released prior to compliance with pre-disbursement conditions and approval by the relevant authorities in the financial institution. 3. 3. 6 MONITORING ; CONTROL OF INDIVIDUAL CREDITS To safeguard financial institutions against potential losses, problem facilities need to be identified early. A proper credit monitoring system will provide the basis for taking prompt corrective actions when warning signs point to deterioration in the financialhealthof the borrower.

Examples of such warning signs include unauthorized drawings, arrears in capital and interest and deterioration in the borrower's operating environment. Financial institutions must have a system in place to formally review the status of the credit and the financial health of the borrower at least once a year. More frequent reviews (e. g. at least quarterly) should be carried out of large credits, problem credits or when the operating environment of the customer is undergoing significant changes. * Funds advanced are used only for the purpose stated in the customer's credit application; * Financial condition of a borrower is regularly tracked and management advised in a timely fashion; * Borrowers are complying with contractual covenants; Collateral coverage is regularly assessed and related to the borrower's financial health; * The institution's internal risk ratings reflect the current condition of the customer; * Contractual payment delinquencies are identified and emerging problem credits are classified on a timely basis; and * Problem credits are promptly directed to management for remedial actions. * More specifically, the above monitoring will include a review of up-to-date information on the borrower, encompassing: * Opinions from other financial institutions with whom the customer deals; * Findings of site visits; * Audited financial statements and latest management accounts; * Details of customers' business plans; * Financial budgets and cash flow projections; and * Any relevant board resolutions for corporate customers. 3.

3. 7 MAINTAINING THE OVERALL CREDIT PORTFOLIO

An important element of sound credit risk management is analyzing what could potentially go wrong with individual credits and the overall credit portfolio if conditions/environment in which borrowers operate change significantly. The results of this analysis should then be factored into the assessment of the adequacy of provisioning and capital of the institution. Such stress analysis can reveal previously undetected areas of potential credit risk exposure that could arise in times of crisis. Possible scenarios that financial institutions should consider in carrying out stress testing include: *

Significant economic or industry sector downturns; Adverse market-risk events; and * Unfavorable liquidity conditions. Financial institutions should have industry profiles in respect of all industries where they have significant exposures. Such profiles must be reviewed /updated every year. 3. 3. 8 CLASSIFICATION OF CREDIT Credit classification process grades individual credits in terms of the expected degree of recoverability. Financial institutions must have in place the processes and controls to implement the board approved policies, which will, in turn, be in accord with the proposed guideline. This guideline may also be called as Credit Risk Grading (CRG), is a collective is a collective efinition based on the pre-specified scale and reflects the underlying credit-risk for a given exposure. A Credit Risk Grading deploys a number/ alphabet/ symbol as a primary summary indicator of risks associated with a credit exposure. Credit Risk Grading is the basic module for developing a Credit Risk Management system. Credit risk grading is an important tool for credit risk management as it helps the Financial Institutions to understand various dimensions of risk involved in different credit transactions. The aggregation of such grading across the borrowers, activities and the lines of business can provide better assessment of the quality of credit portfolio of a FI.

The credit risk grading system is vital to take decisions both at the pre-sanction stage as well as post-sanction stage. Two- types of factors play vital role in modeling the CRG, they are, 1. Quantitative factors 2. Qualitative factors The chart is given in the following page; Quantitative Financial Ratios Loan Repayment performance Credit Ratings Expected Default Frequencies Qualitative Management Quality Tenure in Business Operations

Industry/Niche At the pre-sanction stage, credit grading helps the sanctioning authority to decide whether to lend or not to lend, what should be the lending price, what should be the extent of exposure, what should be the appropriate credit facility, what are the various facilities, on the basis of the above factors.

At the post-sanction stage, the FI can decide about the depth of the review or renewal, frequency of review, periodicity of the grading, and other precautions to be taken. Risk grading should be assigned at the inception of lending, and updated at least annually. 3. 3. 9 MANAGING PROBL EM CREDITS/RECOVERY A financial institution’s credit risk policy should clearly set out how problem credits are to be managed. The positioning of this responsibility in the credit department of an institution may depend on the size and complexity of credit operations. It may form part of the credit monitoring section of the credit department or located as an independent unit, called the credit workout unit, within the department.

Often it is more prudent and indeed preferable to segregate the workout activity from the area that originated the credit in order to achieve a more detached review of problem credits. The workout unit will follow all aspects of the problem credit, including rehabilitation of the borrower, restructuring of credit, monitoring the value of applicable collateral, scrutiny of legal documents, and dealing with receiver/manager until the recovery matters are finalized. Financial institutions will put in place systems to ensure that management is kept advised on a regular basis on all developments in the recovery process, may that emanate from the credit workout unit or other parts of the credit department.

There should be clear evidence on file of the steps that have been taken by the financial institution in pursuing its claims against a delinquent customer, including any legal steps initiated to realize on the collateral. Where there is a delay in the liquidation of collateral or other credit recovery processes, the rationale should be properly documented and anticipated actions recorded, taking into account any revised plans submitted by the borrower. The accountability of individuals/committees who sanctioned the credit as well as those who subsequently monitored the credit should be revisited and responsibilities ascribed. Lessons learned from the post mortem should be duly recorded on file. 4. 0 Findings and Analysis -- Credit Risk Management by IDLC Finance Ltd To perform the overall CRM process 3 departments are working together at IDLC Finance Ltd.

As a leading NBFI in Bangladesh IDLC has always tried to maintain the quality they achieve through 24th year business tenure. These three departments are- Collection of Client information and preparing Appraisal Report CRM Department After getting the approval from the respective authority Internal Control Internal and Compliance (ICC) do all the Control &documentation processes Compliance Collection of installment and managing the overdue rentals as well Special Asset as dealing with the client’s default is Management done by Special Asset Management (SAM) (SAM) * . 4. 1 PROCEDURAL WORK FLOW OF LEASE MARKETING At the initial stage, IDLC concentrated to establish a market and then enlarge the market.

The criteria based on which the market for lease financing has been established are as follows: * Diversification of portfolio * Selecting top industrial unit in the respective industry * Financing for Balancing, Modernization, Replacement and Expansion (BMRE) of existing unit * Priority of existing leases * Set up priority based on sector wise performance Primary focus of IDLC till now is in the area of financial leasing of industrial and professional equipment and vehicles for three to five years term with particular emphasis on BMRE of existing units. Instead of lending funds to purchase equipment, IDLC provides the equipment and extends the exclusive right to its use against specified rental payments at periodic intervals.

There are two types of client for which the procedural work flow would be different though the basic part would be the same. The different types of clients are * Existing Clients – with whom IDLC has already been working * New Clients - with whom IDLC has no business yet The basic procedural work flow is given below: The above procedures are briefly described below: Collect Client & Loan data Compute Credit Risk on the basis of Risk Grade Preparing the appraisal report on the basis of risk Approval by the appropriate authority Documentation Lease/Loan payment collection Creating Provision for default Function of SAM Expiry of Agreement The client applies for required facility through letter. These required facility can vary from different sort of equipments for BMRE to vehicles or expansion projects. The letter generally consists of brief description about the asset to be procured, its price and reason for procurement along with its lease period. * IDLC studies the proposal and sends an offer letter to the client. The offer letter contains acquisition cost, lease period, per month rental and other terms & conditions to be applied if the agreement is done. It is to be noted here that the offer letter is a mere offer and by no means an agreement between the two parties.

Thus, the terms & conditions may change upon final agreement. However, it seldom changes as that will hamper the goodwill of the company. * The client accepts the offer and submits an accepted offer letter. If the client agrees to the terms & conditions of the offer letter, they sign & seal the offer letter as accepted and send it back to IDLC. * IDLC collects initial information about the client. The initial information are * CIB Undertaking & Form XII (if a limited company) for that client to be sent to Bangladesh Bank for CIB Report of the applying client (as per rule of Bangladesh Bank) * IDLC looks for banks opinion for that client The designated Relationship Manager prepares the appraisal report and evaluated the client's proposal. The appraisal report consists of * Background analysis of the company * Management and organization * Cost estimate of equipment/vehicle * Technical and marketing analysis, both from macro and micro level * Financial analysis of the company. i. e. profitability projection, credit report, year wise performance * The appraisal report seeks approval from the appropriate authority. First of all the Relationship Manager places the report to Credit Evaluation Committee (CEC), which consists of representative from Credit Risk Management, Operational Risk Management, General Manager and Deputy Managing Director.

After CEC consent, the report is sent to approving authority. * After approval, the documentation process starts. A sanction ledger is prepared and a sanction letter is issued in the client's name. However, depending on the nature of negotiation, the documentation procedure varies. * The client collects the asset. * Proper insurance coverage is done depending upon the asset and procurement of asset from a selected pool of insurance companies. * The lease operation starts i. e. a formal agreement is signed by both IDLC and lessee. The lessee starts to pay the rental and the lease continues. * Generally, just after the last rental is paid on a regular basis, the transfer of ownership takes place.

Depending upon the negotiated transfer price at the beginning, IDLC transfers the asset's ownership to the client and lease expires. However, the lease operation can also be expired early through partial termination or foreclosure. For new clients the following few steps are added: * Identification of client – the identification of new client is done through relationship management. The main sources of information about new clients are: * Existing client * Word of Mouth * Internal Connection * Client call * Walk-in Client * Prepare extensive appraisal report and seek formal bank & FI opinion. The documentation procedure can differ depending upon the modes of acquisition of asset.

According to the guideline provided by Bangladesh Bank, IDLC considers the following factors while appraising a client and its finance proposal: 1. Business Risk Factors: * Industry * Size * Maturity * Production * Distribution * Vulnerability * Competition * Demand- supply situation * Strategic importance for the group and for the country * Concentration * Market reputation 2. Financial Risk Factors: * Profitability * Liquidity * Debt management * Post Balance sheet events * Projections * Sensitivity Analysis * Peer Group Analysis * Other Bank Lines 3. Management Risk Factors: * Experience/relevant background * Track record of management in see through economic cycles * Succession * Reputation 4. Structural Risk Factors: * Identify working capital requirement Relate the requirement with asset conversion cycle * Purpose of the facilities should be clear and thus mode of disbursement should be preferably structured in a manner to make direct payment to the third party through LC, pay order, Bangladesh Bank cheques etc. 5. Security Risk Factors: * Perishablilty * Enforceability /Legal structure * Forced Sale Value (calculations of force sale value should be at least guided by Bangladesh Bank guidelines) -- 4. 3 WEIGHTS ASSIGNED TO EACH RISK FACTOR CRITERIA WEIGHT | LEVERAGING 20% The ratio of a borrower's total debt to tangible net worth. LIQUIDITY 20% The ratio of a borrower's Current Assets to Current Liabilities. | PROFITABILITY 20% The ratio of a borrower's Operating Profit to Sales. | ACCOUNT CONDUCT 10% Time length of relationship with the client | BUSINESS OUTLOOK 10% A critical assessment of the medium term prospects of the borrower, taking into account the industry, market share and economic factors. | CRITERIA WEIGHT | MANAGEMENT 5% The quality of management based on the aggregate number of years that the Senior Management Team (top 5 executives) has been in the industry. PERSONAL DEPOSITS 5% The extent to which the bank maintains a personal banking relationship with the key business sponsors/principals. | AGE OF BUSINESS 5% The number of years the borrower has been engaged in the primary line of business. | SIZE OF BUSINESS 5% The size of the borrower's business measured by the most recent year's total sales. Preferably based on audited financial statements. | -- 4. 4 MEASURES TAKEN FOR RESTORATION OF DEFAULT CLIENTS The Special Asset Management

Department of IDLC is responsible for mending and improving the repayment pattern of the default clients.

Principal Objectives of the SAM department is keeping overdue situation at possible lowest level so that provision for dues can be minimized so that the negative impact of defaults on the reported profit of IDLC can be kept at minimum level. For this the department goes through the following procedures: 1. Monitoring the overdue situation of the financed projects 2. Initiating procedures as appropriate for each case Some clients fail to make payments of rentals/ installments to the lender/ lessor institution. In several cases, thefailureis temporary, which is eventually paid within a short time. But in other cases, the client continues to default and the situation worsens since it deteriorates the profitability condition of IDLC, just like any other Financial Institution.

So, critical measures are taken on the part of IDLC and these measures are mainly undertaken by Special Asset Management Department. 4. 5 FUNCTIONS OF SPECIAL ASSET MANAGEMENT (SAM) The Special Asset Management Department performs a number of activities to keep the overdue situation of IDLC within minimum level. These are: 1. Overdue Monitoring- Corporate, SME, Syndication 2. Overdue follow Up- Corporate, SME, Syndication(Phone, Visit, letter) 3. SAM Client Follow Up- (Regular, Difficult, Block, Litigated)- Phone, Visit, Letter, Negotiation 4. Termination, Block & Litigation- Initialization, Follow up, Court Attendance 5. Appointment of Lawyers for different Legal Procedures 6.

Recovery Agent Appointment & Follow up 7. Rescheduling- Negotiation, Approval, Follow up 8. Routine works: Receivable Calculation, Closure, Waiver Approval, Adjustments, Reconciliation. 9. Letter Issue- Overdue Clients SAM departmental Targets: 1. Collection of Overdue Rentals 2. Reduction of Non- performing Loans (NPL) 3. Reduction of Infection ratio 4. Bad/Loss Provision Management- Incremental Provision Control 4. 5. 1. RECOVERY ACTION PLAN BY SAM Special asset management takes various recovery actions to reduce the overdue amount, thus reducing the infection ratio. These actions differ on the basis of investment classification as follows; 4. 5. 1. 1 REGULAR ACCO

UNTS (RGACC) Age of overdue: One to Three months * Call immediate ext working day after 1st default installment to remind about overdue. * Try to get specific commitments from client. Committed date should not exceed seven days. * In case of no response from client within seven days, call the client again in order to ascertain reasons for delay and obtain another specific