Unit I — Introduction to Financial Credit

Financial Credit and Risk Analysis | BMB FM 03 (also KMBN FM 05)

Unit I: Introduction to Financial Credit

Syllabus: Financial credit — meaning and objectives; credit risk; credit analysis; the Seven C's; credit analysis process; credit process; documentation; loan pricing and profitability analysis; regulations. Types of credit facilities — cash credit, overdraft, demand loan, bill finance (drawee bill scheme), bill discounting. Cash delivery — types of facilities and modes of delivery.

Exam Blueprint (2023-24 and 2024-25 papers)

Topic	Years asked	Marks
Seven C's of credit	**2023-24 AND 2024-25**	**10**
Credit risk	2024-25	2
Bill discounting	2024-25	2
Collateral	2024-25	2
Types of credit facilities	Syllabus weight	7 & 10
Loan pricing	Syllabus weight	7

YE QUESTION BAAR-BAAR AAYA HAI

Seven C's of credit is the single most important topic in this unit — it appeared as a **10-mark question in BOTH available papers**. Learn all seven with a one-line meaning and an example each. It is close to guaranteed.

1. Financial Credit — Meaning and Objectives

DEFINITION - RATTA MAARO

Credit is the **provision of money, goods or services by one party (the creditor/lender) to another (the debtor/borrower) with the expectation of repayment at a future date, usually with interest.** The word comes from the Latin *credere*, meaning "to trust" — and trust remains the foundation of every credit decision.

DEFINITION - RATTA MAARO

Financial credit refers to the funds lent by a financial institution to a borrower for a specified purpose, on agreed terms as to interest, repayment period and security.

1.1 Objectives of Credit — from the bank's perspective

1. **Earning interest income** — lending is the **primary revenue-generating activity** of a bank
2. **Deployment of deposits** productively, rather than holding idle cash

3. **Maintaining an optimal asset mix** with an acceptable risk-return profile
4. **Building long-term customer relationships** which generate other business (deposits, forex, fee income)
5. **Meeting regulatory requirements** — priority sector lending targets set by the RBI
6. **Supporting economic development** and financial inclusion
7. **Portfolio diversification** across sectors, geographies and borrower categories

1.2 Importance of Credit to the Economy

Credit enables **capital formation** and investment; provides **working capital** for day-to-day business operations; supports **consumption and demand**; enables **entrepreneurship** and new business creation; helps **balanced regional development**; and is the channel through which the **RBI's monetary policy** transmits to the real economy.

1.3 Principles of Sound Lending — the classic framework

Principle	Meaning
Safety	The borrower must be able and willing to repay. *The most important principle* — a bank lends **depositors' money**, not its own
Liquidity	The advance should be repayable when needed; banks cannot lock all funds in long-term loans
Profitability	The lending must earn an adequate return after covering the cost of funds and expected losses
Purpose	The purpose must be **productive and legitimate** — not speculative or prohibited
Diversification	Spread advances across sectors and borrowers to avoid concentration risk
Security	Adequate and realisable collateral as a **second line of defence**
National interest	Lending should conform to national priorities and RBI directives

EXAM TIP - AISE LIKHO

Ek line jo har lending answer me fit hoti hai: *"A bank lends **other people's money** — that is why **safety comes before profitability**. The first question is never 'how much will I earn?' but 'will I get my money back?'"*

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2. Credit Risk

DEFINITION - RATTA MAARO

Credit risk (also called **default risk** or **counterparty risk**) is the **risk of loss arising from a borrower's failure to meet its contractual obligations** — that is, failure to repay the principal or pay interest when due, in accordance with the agreed terms.

(A 2-mark question in 2024-25.)