# Unit II — Trade Credit Risk & Credit Appraisal

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

## Unit II: Trade Credit Risk and Credit Appraisal

**Syllabus:** Sole banking arrangement, multiple banking arrangement, consortium lending, syndication; credit thrust, credit priorities, credit acquisitions; statutory and regulatory restrictions on advances. Credit appraisal — validation of proposal, dimensions of credit appraisal, structuring of loan documents, credit risk, credit risk rating, creditworthiness of borrower, purpose of loan, source of repayment, cash flow, collateral.

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

| Topic | Years asked | Marks |
|---|---|---|
| **Statutory and regulatory restrictions on advances** | 2024-25 | **10** |
| **Purpose of loan and source of repayment** | 2023-24 | **10** |
| **Loan syndication** | 2024-25 | 2 |
| **Sole vs multiple banking arrangement** | 2023-24 | 2 |
| Credit risk rating | Both (Unit V overlap) | 2 & 10 |

**YE QUESTION BAAR-BAAR AAYA HAI**

Do 10-markers is unit se aaye hain — **statutory restrictions on advances** aur **purpose of loan and source of repayment**. Dono ka structure Section 3 aur 5 me diya hai.

## 1. Banking Arrangements — how a borrower is financed

When a borrower's credit needs grow beyond what one bank can or will lend, different arrangements are used. This is a favourite comparison question.

### 1.1 Sole Banking Arrangement

**DEFINITION - RATTA MAARO**

Under a **sole banking arrangement**, the **entire credit requirement** of a borrower is met by a **single bank**, which alone appraises, sanctions, documents, holds the security and monitors the account.

**Advantages:** simple and quick — one appraisal, one sanction, one set of documents; a **close banking relationship** and better understanding of the borrower; the bank has **full control** over the account and the security; lower cost and effort for the borrower; and easier monitoring.

**Disadvantages:** the bank carries the **entire credit risk** — high concentration; the amount is limited by the bank's own **exposure ceiling** and lending capacity; the borrower becomes **dependent on one bank** and has little bargaining power on pricing; and if the bank's own position deteriorates, the borrower's funding is at risk.

**Suitable for:** small and medium borrowers whose requirement is within one bank's comfort and exposure limits.

## 1.2 Multiple Banking Arrangement

> **DEFINITION - RATTA MAARO**
>
> Under a **multiple banking arrangement**, a borrower obtains credit from **several banks INDEPENDENTLY**, with **each bank appraising, sanctioning, documenting and holding security separately**, and **without any formal contract or coordination among the banks.**

**Advantages:** the borrower can raise a **larger total amount**; can **negotiate better terms** by playing banks against one another; is not dependent on a single lender; and each bank keeps its own flexibility.

**Disadvantages — and these matter:**

- **No information sharing** among banks — a serious weakness
- **Duplication of effort** — each bank appraises separately
- **Risk of over-financing** — the borrower may obtain more credit in total than his business justifies
- **Risk of double financing** of the same asset or the same stock
- **Difficult monitoring**; no bank has the full picture
- **Conflict at the time of default** — banks race to enforce their own security
- **Weakened security** — charges may be disputed

> **YAHAN 90% STUDENTS GALTI KARTE HAIN**
>
> Multiple banking me sabse bada khatra ye hai ki **kisi ek bank ko poori tasveer nahi pata hoti.** Isiliye RBI ne banks ke liye **information sharing mandatory** kar diya — har bank ko doosre lenders se declaration aur exchange of information lena hota hai, aur **CRILC** (Central Repository of Information on Large Credits) me bade exposures report karne hote hain.

## 1.3 Sole vs Multiple Banking — the 2-mark comparison

| Basis | Sole Banking | Multiple Banking |
|---|---|---|
| **Number of banks** | **One** | **More than one** |
| **Agreement between banks** | Not applicable | **None** — banks act independently |
| **Appraisal** | Once, by one bank | **Separately** by each bank |
| **Documentation** | One set | **Separate** for each bank |
| **Security / charge** | Held by one bank | Each bank holds its own security |
| **Rate of interest** | One rate | **May differ** across banks |
| **Information sharing** | Not needed | Weak — RBI made it mandatory |
| **Risk to the bank** | **Full concentration** | Shared, but with poor visibility |
| **Suitable for** | Small and medium borrowers | Borrowers needing more than one bank can give |

## 1.4 Consortium Lending

> **DEFINITION - RATTA MAARO**