Unit V — Credit Analysis & Rating

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

Unit V: Credit Analysis & Rating

Syllabus: Importance of credit analysis; stages of credit analysis; profitability analysis and pricing of loans; credit risk analysis (debt ratios and risk of leverage); analysis of working capital, liquidity, operating and cash cycle risk. **Credit Rating** — measurement of risk, objective of rating, internal and external rating, model credit rating, methodology of rating, internal and external comparison, model rating formats.

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

Topic	Years asked	Marks
Objectives / purpose of credit rating	2024-25 (10), 2023-24 (2)	**10 + 2**
Internal credit rating model — components, development, implementation	2023-24	**10**
Credit rating (define)	2024-25	2
Debt ratio	2024-25	2
Benefits of comparing internal and external ratings	2023-24	2

YE QUESTION BAAR-BAAR AAYA HAI

Credit rating is unit ka sabse zyada scoring topic hai. Objectives of rating dono papers me aaya — ek baar 10 marks, ek baar 2 marks. Aur internal rating model ka 10-marker bhi aaya. Agar time kam hai to **Section 6 se 9 pehle padho**.

1. Importance of Credit Analysis

DEFINITION - RATTA MAARO

Credit analysis is the process of evaluating a borrower's **ability and willingness to repay** a loan, and of measuring the **risk of loss** to the lender, so that a sound lend/don't-lend decision can be taken and the loan can be correctly **structured, priced and monitored**.

1.1 Why It Matters — The Asymmetry Argument

PEHLE YE SAMJHO

Ek bank ₹1 crore ka loan 10% par deta hai. Agar sab theek raha to saal bhar me ₹10 lakh interest milega. Aur agar borrower default kar gaya to poora ₹1 crore doob sakta hai. Matlab **upside sirf 10 lakh hai, par downside 1 crore hai.** Isliye lending business me ek default ko cover karne ke liye das achche loans chahiye. Yahi credit analysis ki asli zaroorat hai.

#	Reason	Explanation
1	**Asymmetric payoff**	Maximum gain = interest; maximum loss = entire principal. One bad loan wipes out the profit of many good ones.
2	**Protection of depositors' money**	A bank lends **public money**, not its own. Only 8–10% of a bank's funds are its own capital.
3	**Asset quality and NPAs**	Poor analysis → NPAs → higher provisioning → lower profit → lower capital → reduced lending capacity.
4	**Correct pricing**	Risk-based pricing is impossible without first **measuring** the risk.
5	**Correct structuring**	Analysis decides the **amount, tenor, repayment schedule, security and covenants**.
6	**Regulatory capital**	Under Basel, capital requirement depends on measured credit risk.
7	**Early warning**	Ongoing analysis detects stress **before** the account slips into NPA.
8	**Portfolio management**	Aggregated analysis reveals concentration by industry, geography and group.

EXAM TIP - AISE LIKHO

Exam me pehla line yahi likhna: *"Credit analysis matters because the payoff in lending is asymmetric — the lender's maximum gain is the interest, but the maximum loss is the entire principal."* Ye ek line poore answer ka tone set kar deti hai.

2. Stages of Credit Analysis

The credit process runs in **seven stages**, in strict order.

Stage	Name	What happens
1	**Enquiry & preliminary appraisal**	First screening — does the proposal fit the bank's **loan policy**, exposure norms and target market? Reject early to save cost.
2	**Application & information gathering**	Application form, KYC, 3 years' audited financials, projections, CIBIL / CIC report, existing banker's opinion, IT returns, GST returns.
3	**Detailed appraisal**	The core analysis — five dimensions: **Managerial, Technical, Market, Financial, Economic**.
4	**Risk rating**	The credit is scored on the bank's **internal rating model** (Section 8).
5	**Sanction & structuring**	Sanction by the appropriate authority; limits, margin, security, interest rate, covenants and repayment schedule are fixed.
6	**Documentation & disbursement**	Execution of loan documents, creation and registration of charge, end-use verification, then disbursement — often in tranches.
7	**Post-sanction monitoring & review**	Stock statements, QIS returns, unit inspection, account conduct, annual review, rating migration, early-warning signals.