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DCM LEVEL III

PRACTICE OF CREDIT MANAGEMENT

TUESDAY: 28 November 2017. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

PESA BANK

Pesa Bank is a commercial bank which was started in 1983 as a credit trust. It was designed to promote a range of financial services to the rural population.

In 1993, Pesa Bank was registered as a commercial bank. Like other commercial banks, lending is the principal business activity of Pesa Bank. Its loan portfolio is typically the largest asset and the predominate source of revenue hence, it is one of the greatest sources of risk to the bank's safety and soundness.

Consequently, Pesa Bank has put in place basic loan portfolio management principles which include determining whether risks associated with the bank's lending activities are accurately identified and appropriately communicated to senior management and the board of directors.

Lending policies in Pesa Bank

In addition to the regulations set by the Central Bank, Pesa Bank also formulates inside credit risk regulations to guide the loan officers, and thereby reduce the bank's credit risk. According to the bank's annual report 2016, comprehensive resources, expertise and control are in place to ensure efficient and effective management of credit risk. The credit risk is managed by means of a governance structure with clearly defined mandates and delegated authorities.

The board risk committee delegates authority to the management credit risk committee for approval of credit proposals. The management further delegates authority within its limits, primarily on a risk adjusted basis.

Maintaining loan portfolio quality within acceptable limits

Pesa Bank credit policies and procedures state that, for effective recovery/monitoring of loans, all outstanding loans in the portfolio shall be closely monitored with the aid of the computer system. Reports generated by the system on a daily, weekly and monthly basis are used by the branch managers and the head office for monitoring and control of the arrears, and general quality of the lending business. The branch loan committees normally hold recovery meetings at least twice a month to review all loans in arrears on each loan officer's portfolio. A loan officer is fully responsible for the follow up and recovery of all loans in his or her portfolio. Efforts are made to ensure that loans in arrears are recovered before they are more than 30 days in arrears. Loans which however, are more than 30 days in arrears are recovered in collaboration with the head of department or a recovery officer.

All loans in the commercial portfolio are continuously monitored to ensure that portfolio quality does not deteriorate. Loan officers are supposed to monitor the performance of borrowers primarily to reassure themselves that a borrower will continue to be in a position to honour the terms of the loan and that the quality of the loan portfolio is within acceptable parameters.

The credit policy of Pesa Bank asserts that, at least every month the head of the branch credit department shall undertake a thorough review of all loans more than 30 days in arrears and report to head office on the reasons for loan failure. This is a valuable feedback on the effectiveness of the bank's loan policy and procedure. In addition, special credit reports are from time to time requested by the head office.

Required:

(a) Discuss five principles of effective loan portfolio management that Pesa Bank could apply in managing their loan portfolio. (10 marks)

(b) Analyse five factors that Pesa Bank should consider in its loan policy in order to minimise credit risk. (10 marks)

(c) The board approved policies on credit management must mandate a consistent lending process and related internal controls.

With reference to the above statement, advise the management of Pesa Bank on seven elements of a properly functioning loan approval process. (7 marks)

(d) Describe seven performance measures that the management of Pesa Bank could use to evaluate its loan portfolio performance. (7 marks)

(e) Propose six contents of special credit reports which could be sent to head office by branch credit managers. (6 marks)

(Total: 40 marks)

QUESTION TWO

(a) Distinguish between "vertical debtor pursuit" and "horizontal debtor pursuit" as used in debt collection. (4 marks)

(b) The art of listening is key in debt collection.

With reference to the above statement:

(i) Highlight three levels of listening ability that a successful debt collector should possess. (3 marks)

(ii) Propose eight ways in which a debt collector could improve on their debt collection listening skills. (8 marks)

(Total: 15 marks)

QUESTION THREE

(a) In any business, whatever its size, credit management missions are essential. They must be designed and organised by top management.

With reference to the above statement, analyse five objectives of credit management. (5 marks)

(b) Discuss five challenges to successful implementation of credit risk management in a financial institution. (5 marks)

(c) Enumerate five benefits that could accrue to a firm as a result of good management of its cashflow. (5 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Examine four types of outputs from a computerised sales ledger system. (8 marks)

(b) Suggest four reasons why companies use factoring services. (4 marks)

(c) Describe three features of a good security. (3 marks)

(Total: 15 marks)

QUESTION FIVE

(a) (i) Explain the term "Financial Covenant". (2 marks)

(ii) In relation to company's debt structure, management and ongoing operations, examine four primary and four secondary financial covenants that a lending institution should include in its loan agreement in order to minimise credit risk. (8 marks)

(b) Highlight five conditions and warranties that govern hire purchase contracts under the Hire Purchase Act. (5 marks)

(Total: 15 marks)

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