
DELVING A BIT DEEPER INTO THE PROCEDURE OF CREDIT RISK ANALYZATION

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ABSTRACT

This manuscript deals with the basic procedure of credit risk analyzation where, the bank needs to go through the thorough details of the borrower, in order to understand the capability of the borrower of returning or paying off the loans that has been taken by him. The process of credit analyzation helps in the proper conduct of the entire lending procedure of the bank, it gives the bank or the creditor a sense of security, which is an important element in the functioning of any financial institution. This manuscript also describes a little bit about the credit risk management process or strategies that can be followed by the lenders or creditors in order to ensure the security of their respective businesses. This entire process of credit risk analyzation as well as credit risk management has been briefly yet thoroughly described in the writing below.

Introduction-

Credit risk analyzation is taken into consideration when a particular bank is about to lend money to the customer or borrower. After the lending procedure is over, the bank becomes dependent on the borrower for the repayment of the money, hence the stability of the customer's bank account comes into question. Credit risk analysis helps the bank in understanding the strategy of the borrower regarding the loan repayment procedure. It tells the bank about the probable loss that might be caused to the bank in case the borrower fails to repay the amount of loan that has been credited to him by the lender. The presumption of any inability of the borrower to repay the loans will automatically enhance the financial risk of the creditor. In order to reduce the possibility of credit risks¹, the lender must be well-versed with the information of the borrower.

The determination of the interest rates-

The interest rate that the bank is going to charge, somewhat depends on the stability of the borrower's financial condition. In case the bank finds a borrower having a lower credit risk², the borrower will be charged with lower interest rate, however, borrowers having a higher credit risk are charged with comparatively higher interests. Interests charged by the banks are nothing but security to the creditor or in other words it can be said that interests received from the borrower are a lender's reward for assuming the credit risk. It is never possible to estimate the exact risk that might take place, however, an early anticipation or presumption of the risk, can reduce the financial risk of the lender. In case, the credit risk is found to be much higher, then the bank might decline the offer to pay the loans. Banks or lenders will always prefer a borrower with a stable financial condition³, and in turn the bank will choose to offer lower interest rates to them because of the low credit risks.

Management of Credit risk-

Credit risks can be measured by carefully observing the consistency of the borrower pertinent to the repayment procedure of the loans that has been taken by him. Any lender if follows the 5Cs⁴, then he can reduce the credit risk to some extent. The creditor's information collection

¹ Credit risks ,Readyratios, https://www.readyratios.com/reference/analysis/credit_risk.html

² Open Risk manual, Low Credit risk, https://www.openriskmanual.org/wiki/Low_Credit_Risk

³ Financial stability, The World Bank, <https://www.worldbank.org/en/publication/gfdr/gfdr-2016/background/financial-stability>

⁴ What is credit risk analysis and why is it important, Imarticus, (July 3,2019), <https://blog.imarticus.org/what-is-credit-risk-analysis-and-why-it-is-important/>

plays a huge role in the initiation of a successful credit analyzation procedure. This particular step aims towards accumulating the borrower's credit history. The lender shall be very much well aware regarding the various information of the borrower. The information that the lender needs to be aware of includes the past repayment record of the customer, organizational reputation, financial solvency, stability of the finances, and various other transactional records. By looking into the information of the borrower, the lender will be able to examine the capability of the borrower to return the money within the stipulated time period as has been agreed by both the parties.

Understanding the transparency through verification-

The lender should be well aware of the nature of the borrower in order to understand the borrower's mind set when it comes to growing a business, because the more the borrower has a positive approach towards developing his own business, the more the lender will be sure of the very fact that the borrower is capable of generating additional cash flows. The authenticity of the loan is also a matter of concern that needs to be looked into by the lender with utmost care and sincerity. At certain times it is observed that the purpose of the loan that has been stated by the borrower turns out to be absolutely vague in nature. Hence, it is the obligation of the lender to investigate the transparency of the reason for which the loan has been claimed. At times, the borrower becomes insolvent while paying off the loan, therefore, the lender needs to be well aware of the back up plans that the borrower is having in case his present business suffers a loss. In case the lender finds the fact that the borrower is not having a proper planning in mind regarding a backup plan, then he should step in and give the borrower a proper suggestion regarding how he can continue paying off the loan even if he is stuck in a financially adverse condition.

Conclusion-

Credit risk analysis is a time bound process, however, that does not restrict the lender from delving deeper into the various information of the borrower. Verification is a major footstep that needs to be followed with proper intelligence and sensibility. The lender, in order to determine the transparency of the borrower might visit some of the project locations or job locations of the borrower, in order to verify whether the borrower has been honest about his past or present business experiences. A proper functioning of the lender will automatically lead to a better credit risk management, for the bank or any financial institution.