



Credit Policy Formation of Commercial Banks (Special ref to Central Bank of India)

Sonam Bais¹, Dr. Tapes Chandra Gupta²

¹Research Scholar, Govt. J Yoganandam Chhattisgarh College, Raipur.

²Professor, Faculty of Commerce, and supervisor Govt. J Yoganandam Chhattisgarh College, Raipur

Abstract:

This research paper refers to analysis of credit policy structure in commercial banks and its implementation in Indian banking system. This paper is basically to make awareness about the banking credit policy structure followed by the department internally.

In the banking credit policy, there are some Different types of Influencing factors plays role to determine the Credit policy of banks. The Strategy follows in formation of credit policy of banks. The credit policy improves the profitability and credit risk reduction of banks. Defined phases credit policies of banks in terms of macroeconomic instability. This research Findings Focused on credit policy models can cause decrease in NPL Ratio, rating factor that affects credit risk in lending strategy.

RBI Policy or RBI Monetary Policy is a policy adopted by the Reserve Bank of India (RBI), the monetary authority of India, to regulate the interest rate or the amount received on loans.

Keywords: (Credit policy, risk factors, Commercial bank, borrowers, credit strategy etc.)

Introduction

Bank: The Bank is a financial institution which has started in the 18th century and continues to present date. The financial system is an important tool for countries seeking to develop economically. The reason is that it helps create wealth through investments. That's why there are different types of financial services to alleviate these requirements. Banks are one of the important ways countries control financial transactions and services. Banking in India has been the backbone of many businesses both past and present. **Different types of banks: central banks, commercial banks, investment banks, cooperative banks, postal banks.**

A central bank is the main banking institution of any country in the world. In India, it is **the Reserve Bank of India (RBI)**. They are responsible for many things such as managing the country's currency, money supply in the system, foreign exchange, and more. Most of these central banks are owned by the government. **RBI** has Introduces and upgrades safe and efficient modes of payment systems in the country to meet the requirements of the large public.

I would like to focus on **Commercial Banks** here,

The basic object of the **commercial banks** is to lend and invest money to both businesses and the public. Hence, there are two types of commercial banks in India. These are scheduled commercial banks and unscheduled commercial banks.

The **Central Bank of India (CBI)** was the *first Indian commercial bank* to be 100% Indian owned and operated. The establishment of the bank in 1911 is the ultimate realization of the dream of the bank's founder, Sir Sorabji Pochkhanawala.

In 2008 Central Bank of India entered into distribution tie up with Kotak Mahindra Asset Management Company. Under this agreement it will offer entire products of Kotak Mutual Fund products from the bank's branches.

Central Bank of India has signed a Memorandum of Understanding with WMG, an Academic Department, and University of Warwick. The MOU provides for several areas of cooperation including provision of fast-track loans for Indian students studying at WMG and the building of cooperative relationships between UK and Indian business and also the development of a low cost housing project.

Among the Public Sector Banks, *Central Bank of India can be truly described as an All India Bank*, due to distribution of its large network in 27 out of 29 States as also in 3 out of 7 Union Territories in India.

Credit Policy of Commercial Bank: The bank has adopted credit policy which is regulated by the Reserve bank of India. In India RBI circulate the guidelines for lending procedures which is followed by banks to allow lending process to borrowers.

The Credit Policy known as Monetary Policy. The RBI is responsible for promoting financial inclusion by improving credit transfers, assisting banks in times of financial shortfall, setting standards for lending and borrowing, and developing policies that exclude individual lenders.

Other key factors about credit policy:

- This policy aims to segment the credit approval processes based on categorization Based on borrowers, nature of primary /collateral security.
- The Loan Policy is reviewed every year to keep in sync with the market realities, business priorities, Govt. policies and regulatory requirements.
- The policy strives to ensure that the socio economic obligations cast on the bank are fully met. The Bank's general approach to Export Credit and Priority Sector Advances are set out in the Policy.
- The policy seeks to ensure continuous growth of loan assets while endeavoring that they remain secure, performing and standard.
- The policy endeavors to mitigate and reduce risk associated with the lending by fine tuning the systems and procedures.
- The policy sets out optimum exposure levels to different sectors in order to ensure growth of assets in an orderly manner in line with the Risk policy.
- The policy lays down norms for take-over of advances from other banks/FIs. Bank's stand on granting credit facilities to companies whose Directors are in the defaulters list of RBI is covered

in the Policy.

- The policy document ensures updated compliance of all directives/guidelines issued by the Government/RBI and all other regulatory requirements on credit matters. With regard to guidelines issued from time to time by the authorities, the Bank would follow them in all their aspects. However, if these permit varying interpretations, the Bank will adopt a reasonable interpretation, as determined by the Credit Risk Management Committee without deviating from the spirit behind the guidelines.
- This policy would govern all credit and credit related exposures, Fund Based as well as Non-Fund based and prescribe acceptance criteria for all forms of credit dispensation. These would include Short term, Medium term and Long term facilities, as also Letters of Credit, Standby Letters of Credit, Guarantees, and Acceptances, Forward Contracts and Derivative contracts etc.
- The policy will encompass exposure borrower wise i.e. exposure to all types of customers such as individuals, proprietorship firms, One Person Companies (OPCs), Partnerships, Limited Liability Partnerships (LLPs), association of persons, Trusts, Societies, Companies registered under Indian companies Act, State/Central Govt PSUs & others and also industry / activity wise.

Research Methodology: The fulfilment of Research object method is used descriptive research only. Here is only focused to understand the credit policy its structure and implementation steps followed by the bank but with RBI NORMS. This paper is based on secondary data mostly. Primary data mode is direct interview with the bank employees, loan officers and borrowers.

Objects of study:

This research paper is prepared to understand:

- Credit policy of commercial banks
- Credit policy structure
- Risk factors affecting in formation of credit policy structure

Research Out comes:

According the updated RBI circulation regarding loan process here is checklist in detail which is followed by the banks for any loan process.

Checklist For Credit Sanction Process Followed By Loan Department And Team of the Bank

1. Application scrutinized to verify,

- a) Original Salary Certificate for previous month and Original Salary Certificate/ other satisfactory evidence in case of co-applicant is submitted.
- b) In case self-employed / any other person if loan amount above Rs. 5.00 lacs income tax returns for preceding two years is submitted.
- c) Loan applied is for specific purpose as permitted under the scheme

- d) Wherever applicable, consent letter for giving guarantee with full details is obtained from the guarantor.
 - e) Quantum of loan applied is within the permissible limit considering income of the borrower and co-borrower and cost of house/flat or cost of repairs/ extension etc.
 - f) Borrower satisfies age criteria. g. Repayment period requested is not beyond stipulated maximum in case of construction / acquiring new house etc. and 10 years in case of repairs / renovations etc.
2. Identity of the Borrower and Guarantors properly established. To be established as far as possible with introduction given by existing customers or by verifying any of the following documents.
- a. Pass Port.
 - b. PAN Card.
 - c. Voter ID.
 - d. Identity Card issued by Employer.
3. Assets and Liability declaration from borrower, co-borrower and guarantor/s obtained.
4. Financial Reports of borrower / guarantors drawn wherever necessary.
5. Proof of income i.e. salary certificate, I.T. returns / assessment order obtained and genuineness verified.
6. Pre-sanction inspection is carried out. The Verification / inspections should be done independently.
7. Residential address of borrower / business place independently verified, preferably by personal visit / by sending call card / telephone call etc.
8. Borrowers bank account statement / pass book for at least a year obtained and verified for ascertaining other liabilities / fixed outgoing.
9. Following declarations obtained. a. The borrower has not defaulted in repayment of loan of our bank or other bank or entered into compromise settlement in any capacity. b. The borrower is not related to any of our Bank's Director or Director of other bank. c. Consent clause for disclosure of names in case of default to RBI / CIBIL etc.
10. After scrutiny of application and ensuring receipt of all necessary documents / papers acknowledgement is given to the applicant.
11. Risk Rating done using Manual Scoring Model for DHFS. It is ensured that the arrived score is more than hurdle rate of 50.
12. Option letter regarding rate of interest, whether fixed or floating obtained.
13. Legal search report from panel advocate obtained as per Co. circular.

Nature of title deeds may differ from case to case for e.g. house being constructed by the borrower, flat being purchased from already registered cooperative housing society, from builder where society is yet to be formed and title of land yet to be conveyed, ready possession flat in second sale or extension/renovation/repairs of the existing house/flat.

Hence, proper care to be taken while accepting documents of title for creation of equitable/registered mortgage.

List of generally obtained documents: Sale deed/Agreement for sale/Allotment letter from housing board/NOC from society, share certificate from the society, undertaking from society regarding registering banks charge, Borrower-Builder-Bank Tripartite Agreement (wherever applicable).

14. Valuation report in prescribed format obtained wherever necessary.
15. Estimate of construction cost obtained wherever necessary, giving stage-wise break-up of expenses for construction.
16. Verified approved plan of construction and other necessary permissions/approvals are obtained from the government authorities/statutory bodies.
17. NOC under Urban Land Ceiling Act, Conversion Certificate (for converting agricultural land for non-agricultural purpose) obtained wherever necessary.
18. Pre-sanction inspection carried out.
19. Photograph of property to be mortgaged obtained at different stages from different Positions
20. Verified whether the residential project/builder is approved by our Bank.
21. NOC/allotment letter obtained from the housing society wherever necessary.
22. Insurance cover with Bank Clause arranged.
23. EM created taking all necessary precautions and following instructions as given in the manual of instructions.
24. Source of margin money ascertained to ensure borrower has capacity to save.
25. Post-dated cheques obtained.
26. Process note prepared.
27. If sanctioned, detailed sanction letter incorporating all terms & conditions is prepared and given to the borrower obtaining acknowledgement.
28. Sanction must carry signatures of two officers-one recommending and other sanctioning.
29. Post-sanction inspection carried out / programme for inspection at future dates in case of house under construction is chalked out. The post sanction inspection should be carried out by the official other than who has carried out pre inspection.
30. Loan properly categorized in PS/NPS.
31. Documents got executed before disbursement.
32. Proper charge created on other security like NSCs, LIC Policies offered as security after verification of genuineness wherever necessary.
33. Processing fee recovered.
34. Reported in Annexure II. Separate Annexure II for sanctions with deviation/s.
35. All Circulars relating to DHFS are in proper file.

These process and structure may vary from loan to loan like Home loan, MSME, vehicle loan and other classified loans.

Risk factors in implementation and formation of credit policy in commercial bank

The cause can Affect the Formation of credit policy of banks can be market competition, financial position, nature of product, capital adequacy, due diligence and risk factors.

Here is Describing Influencing factors in details,

1. Market competition: policy should be competitive with comparison to the peer banks.
2. Financial position: policy should suit the appetite of the banks, term and period of granted for particular credit should not exceed as compared to the cost running. As NIM (Net interest margin) is determining factor for profitability of any financial position.
3. Nature of product: The nature of product is main underlying factor to determine the risk weightage and period of loan i:e Agriculture loan will have low risk weightage and revenue as compared to credit offered to MSME segment.
4. Capital adequacy and IRAC norms: After implementation of BASEL Norms capital adequacy norms for landing should be followed, this is based on factor like internal rating due diligence and market discipline and most important repayment capacity of the borrower.
5. Risk factor: There are various risk factors like credit risk, market risk, political risk, and operational risk play vital role in formation of credit policy of banks.

There are some factors discussed but it can be derived depends on different aspects.

Conclusion: Therefore determining the optimal credit strategy is a complex multistage task, the solution lies in the use of modern concepts of banking analysis and the use of effective ones Tools. When determining the loan fee, the bank should consider the following factors: the market of credit sources, especially the credit agreement, the degree of risk, the term of the credit, and the method of providing credit to ensure its repayment etc.

In the Indian economy, RBI's role in credit control is very crucial. The Reserve Bank of India controls the flow of credit in our economy to keep inflation and economic growth under control. Credit changes can cause market volatility, so credit control policies need to be carefully planned before implementation.

Problems and Suggestion: The commercial bank's credit policy leads to lending confusion and complexity which can lead to miss the important steps and can be the reason for NPL. Credit policy provides a framework for the credit process that it influences commercial bank performance. However, loans have carrying costs when they are not repaid time, as they represent a credit risk factor with associated credit support costs function because the cost of capital will rise relative to the added risk as capital is outstanding for a long time in the events of today's payments.

Futures Research Scope: Factors that contribute to the successful implementation of an effective credit management policy in commercial banks of India.

Reference

- ¹Kovalova, O, and M. Iorgachova. "CREDIT POLICY OF A COMMERCIAL BANK IN CONDITIONS OF UNCERTAINTY OF THE ECONOMIC ENVIRONMENT." *Financial and Credit Activity: Problems of Theory and Practice* 5 (November 8, 2021): 65–75. <https://doi.org/10.18371/fcaptop.v5i40.244889>.
- ²McCoy, John W. *Bank Credit Policy and Procedures Manual*. 1st edition. www.amazon.com, 2011.
- ³Reddy, Y V. "Credit Policy, Systems and Culture," 2004.
- ⁴Svitlana, Andros. "CREDIT POLICY OF COMMERCIAL BANKS AND ITS EFFECT ON BANKING" 1, no. 3 (2011).
- ⁵"Credit Policy of the Bank." Accessed February 8, 2023. <https://bank.com.ua/en/kreditna-politika-banka>.
- ⁶"Regulations on Requirements to Credit Policy of Commercial Banks." Accessed February 8, 2023. <https://cis-legislation.com/document.fwx?rgn=8027>.
- ⁷"Profile | Central Bank of India." Accessed February 11, 2023. <https://www.centralbankofindia.co.in/en/about-us/profile>.
- ⁸"Annual Reports | Central Bank of India." Accessed February 15, 2023. <https://centralbankofindia.co.in/en/node/219218>.



¹ Kovalova and Iorgachova, "CREDIT POLICY OF A COMMERCIAL BANK IN CONDITIONS OF UNCERTAINTY OF THE ECONOMIC ENVIRONMENT."

² McCoy, *Bank Credit Policy and Procedures Manual*.

³ Reddy, "Credit Policy, Systems and Culture."

⁴ Svitlana, "CREDIT POLICY OF COMMERCIAL BANKS AND ITS EFFECT ON BANKING."

⁵ "Credit Policy of the Bank."

⁶ "Regulations on Requirements to Credit Policy of Commercial Banks."

⁷ "Profile | Central Bank of India."

⁸ "Annual Reports | Central Bank of India."