

# CAB Training Cards



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## Credit Monitoring

### Why Monitoring

Assessing proposals, granting and disbursing loans are but one part of a lender's responsibility. The other is – keeping a watch on the borrower's activities till the moneys due from him are recovered in full. This is called *credit monitoring*. Its objectives are:

- Checking compliance with the terms and conditions (T&C) for the loan
- Ensuring legal enforceability of the documents collected from the borrower
- Keeping an eye on the end use of funds by the borrower
- Ensuring that the security is physically and legally recoverable
- Sniffing out 'early warning signals'

### Stages of Monitoring

Monitoring has to be undertaken both in the: (a) pre-sanction stage; and (b) post-sanction stage.

#### (a) Pre-Sanction Stage

- *Compliance with KYC/Customer Due Diligence Norms from RBI*: helps establish identity, makes the bank categorise customers on riskiness, based on account activity
- *Analysis of documents from the borrower, credit information companies' reports, no-dues certificates from other bankers, wilful defaulter list from RBI, records maintained with the Registrar of Companies, Income Tax Returns, etc*: helps get financial data for appraisal, information about credit-worthiness and the state of indebtedness of the customer
- *Market Information*: information from other businessmen about stresses and strains in the borrower's business; technical and commercial developments, changes in legal and regulatory environment – these factors influence business success and sustenance
- *Pre-sanction Visit*: helps get real-time data on the status of occupancy of premises, ownership, activity-level, possibility of future expansion, etc.
- *Valuation of Security*: gives a picture about recoverability in case of delinquency. Frequency of the valuation exercise is

also important. Legality of charge creation must also be established

#### *(b) Post-Sanction Stage*

- *Pre-disbursement audit*: helps check whether the T&C of the loan have been complied with. Includes documentation, charge creation, etc. Written acknowledgement from the borrower accepting the T&C of the loan must be collected
- *Account Operations and Checking for End-Use*: fund usage must be in sync with the ebb and flow of the business activity. Can help check for diversion/ siphoning. Disbursements must be as per defined milestones. Margin from the borrower must be checked. Check if all debits and credits are being routed through the account with the bank. Keep an eye on utility bill payments – timeliness and level of usage can indicate business volume
- *Insurance of Security*: helps protect assets charged to the bank from various risks. Policy must be current. The bank's charge on assets must show in the insurance company's records
- *Unit Visit Reports*: Direct check on the level of activity, raw material usage, stocking of inventory, putting of bank's name on stock or machinery charged to the bank, condition of power-supply, logistics, etc.

#### **Early Warning Signals (EWS)**

Monitoring may throw up some tell-tale signs of stress, i.e. EWS. A few examples are:

- *High business inflows in the account but unusual debits*: may indicate diversion/siphoning
- *High credit entries, disproportionate to expectations*: may indicate loans from other lenders
- *High Sales Returns*: may indicate quality concerns
- *Frequent return of cheques/demand for Temporary Overdraft*: may indicate financial strain
- *Low level of transactions in the account*: may indicate routing of business through another account
- *Delayed submission/non-submission of control statements (e.g. stock statement)*: may indicate failure/over-optimism of the business plan

It is for the banker/lender to take reasonable action based on the revelations of the monitoring exercise. In general, for stressed accounts, three steps – rectification, restructuring or recovery, may be adopted.

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