kasneb

CCP PART III SECTION 6

CREDIT PRACTICE

FRIDAY: 24 May 2019. **Time Allowed: 3 hours.**

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

QUESTION ONE

EDEN VILLE SACCO (EVS) LIMITED

Eden Ville Sacco Limited (EVS Ltd.) is a sacco that is at the brink of collapse and this is after being in operation for twenty five years. In the first fifteen years, EVS Ltd. was initially registered as a group composed of members from the metal works section of Gulubu, one of the major towns in the country.

These members were dedicated blacksmiths who had chosen to come together and pull together their savings so as to advance credit to their own for business growth among other financial needs and purposes.

Initially, members were using table banking but with the help of financial literacy from the Chamber of Commerce and Industry, they got encouraged to take the organisation to the next level and that is how the sacco came into being.

Among the pioneer sacco members were the metal works investors. The metal works investors were very learned entrepreneurs who were identified by the guiding committee from the chamber of commerce for pioneering the transformation of the registered group into the current sacco.

Registration of the sacco met all regulatory requirements and was duly licensed with licence renewals being done annually as per the regulatory guidelines.

The sacco's activities picked up well but due to the growth prospects, the common bond for members' pool was opened to cater for all businesses provided a track record of performance could be proved for at least three years. The loan demand has increased over time and as a result collateral requirements have been enhanced from members' guarantees to include the conventional securities on a need basis. The sacco has been advancing large loan amounts to businesses provided the collateral so provided is adequate.

A member applying for a loan using collateral, is advised to undertake a valuation report for the collateral. Recently, the sacco has been recording poor performance and as a result the regulator has sent its supervisors on an investigation so as to have an independent report as regards the sacco's operations in addition to the external audit reports and recommendations. Preliminary working papers of the supervisors indicate a number of issues that could easily be associated with the saccos declining profitability and dismal performance. Due diligence on a sample of the assets taken by the sacco as security, has revealed that the values of most of the assets taken as security were exaggerated at the time of booking the loans. The values used to book the loans were far much less compared to what was reflected in the valuation reports. Further investigations point to collusion between the assets valuers, borrowers and lending officers.

Collections on loan repayments are done by the loan officers. The loan officer's primary duty is to grow the loan book via disbursements of new loans. The sacco has no credit officers charged with loan recovery. Report on the debt recovery is generated one week past the due dates and the customers are reminded of their instalments arrears via phone text messages, calls and dunning letters. A scrutiny of this exercise indicates that track sheets for these follow ups are not maintained both in the sacco's information system and on the manual collection files. As such there is no co-ordinated loans review system since the only exercise that is a kin to this is the monthly reporting of the past and due accounts.

Further, the information contained in the borrowers' files, especially for the defaulted cases, is not reliable as most of the contact information is not correct. This indicates lapses in information verification at the onset of the credit provision for use in future correspondences with borrowers.

The investigators also interviewed a couple of former employees whose services were terminated on the grounds of fraudulent lending, so as to find out the motives and causes behind their fraudulent activities. Nearly all of them cited stretching targets leading to too much work with unmatching remuneration as the main reasons that pushed them to the misconduct. At the conclusion of its investigation, the supervisors have recommended to the regulator that your firm, which does credit management consultancy, be appointed to guide the sacco's management in managing its delinquent portfolio of loans so as to improve its performance.

Required:

(a) (i) Citing evidence from the case study, evaluate four areas that EVS Ltd. has failed in its management of delinquent loans. (8 marks)

(ii) Propose four remedies to the failures identified in (a) (i) above. (8 marks)

(b) Loans review is a process that if regularly conducted could be of immeasurable aid in a lender's quest for proper management of delinquency. With reference to this statement and looking at EVS Ltd.'s situation:

(i) Discuss the five principles of loan review. (5 marks)

(ii) Advise on five features that EVS Ltd. should consider when structuring the loan review process. (5 marks)

(c) Evaluate six features of troubled loans that the management of EVS Ltd. should note in its loans portfolio for timely remedial actions to be taken. (6 marks)

(d) Discuss the steps involved in loan work-outs, the process of recovering funds from problem loans situation, so as to help the management of EVS Ltd. to better its loans recovery strategies. (8 marks)

(Total: 40 marks)

QUESTION TWO

(a) Examine five disadvantages of inadequate working capital. (5 marks)

(b) Explain three legal documents used in loan work-out agreements. (6 marks)

(c) Outline four indicators of a company in financial distress. (4 marks)

(Total: 15 marks)

QUESTION THREE

(a) Identify five types of risks inherent in a loan facility. (5 marks)

(b) Discuss three Pillars of Basel III Accord. (6 marks)

(c) Describe four benefits of undertaking credit portfolio risk analysis. (4 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Describe four implications of International Financial Reporting Standard (IFRS) 9 "Financial Instruments" on the business model of financial institutions. (4 marks)

(b) Analyse three components of the Altman's Z-score insolvency prediction model. (6 marks)

(c) Identify five internal factors that could cause delinquency in a firm. (5 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Discuss three approaches to the credit evaluation process. (6 marks)

(b) Enumerate four types of credit events. (4 marks)

(c) Propose five mechanisms a commercial bank could use to reduce the risk of loan delinquency. (5 marks)

(Total: 15 marks)

....