Mastering the Credit Processing Mechanism in Mauritius

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Demystifying the Process

By

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Disclaimer note: Though utmost care has been taken to ensure precise and accurate reporting of information, nonetheless, the author accepts no liability whatsoever in the case of any feasible misreporting.

Dedicated to all those whom I met during my career in the field of credit processing. Also dedicated to my parents and God.

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PREFACE

This book focuses on the credit processing mechanism pertaining for Mauritius. It is widely known that Mauritius is inherently a bank-based financial system, however, many people are oblivious of the credit processing mechanism. The aim of this book is to fulfill such a vacuum.

Who should read this book?

The book is targeted for the following audiences:

(a) Credit officers, managers, new recruits, basically anyone involved in credit processing.

(b) University graduates enrolling for banking courses and chiefly those willing to embark a career on credit analysts.

(c) For borrowers (individuals and companies), willing to know how their credit requests are being processed.

(d) Researchers (both academics and practitioners).

(e) Anyone interested in knowing the gamut of credit processing in Mauritius.

Knowledge is like a fathomless sea in that so much of what you already know hinges on everything else there is to learn. In that perspective, the thirst for more knowledge is perpetual and ironically, such a thirst tends to remain constantly unquenched. Perhaps, this is why it has truly been said that "Education starts in the womb and ends in the tomb". I would say if the soul is eternal, education is eternal, manifesting beyond under the life-birth cycle.

Dr. Indranarain Ramlall
July 2017

CHAPTER ONE

A BRIEF INTRODUCTION TO THE CREDIT PROCESSING MECHANISM

"Can someone tell me how a loan is usually processed?"

Interaction with Customers

Credit analysts should be well versed in all advances products offered by their bank. While interacting with the customer, they should see to it that the client is receiving the right information and provides value-adding advice in terms of the correct financing structure. If the customer agrees to take the loan, the credit analyst should ask for all the important information at one time. However, in practice, it does happen that while preparing the credit proposal and going through all the supporting documents provided by the client, the bank officer/credit analyst will find some additional information is required, which was initially not deemed vital.

MCIB Report

Basically, all banks in Mauritius should be converted to the Mauritius Credit Information Bureau. As per the rule stipulated by the Bank of Mauritius, with any credit processing (whether new credit arrangements or renewing of banking facilities) there an MCIB report must be generated. This report is created not only for the borrowers but also for the guarantors.

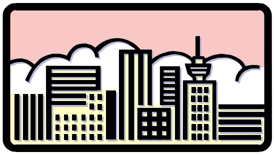
Credit Processing

The credit analyst should prepare a credit processing report to provide all information that is needed for a sound decision with a view to cushioning the customer as well as the institution.

Time Constraints and Proper Time Management

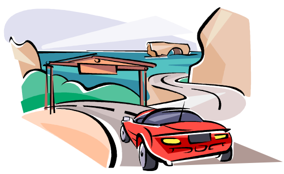
Customers

Conservator of Mortgages



The aim is to have a complete search on the assets owned by the borrower/guarantor and liabilities secured there against the borrower/ guarantor. It is imperative to properly ascertain the position of Assets and Liabilities of an applicant; a search must be conducted in the office of the Conservator of Mortgages. Examination of search reports is prerequisite for all credit exposures, except for those fully secured by the bank's deposits or unsecured advances.

Site Visit



A site visit should be undertaken to ascertain the end use of funds and better understand the business operations. The credit analyst is also required to generate a report regarding the site visit and whether any anomalies have been found.

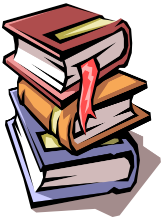
Liaising with Internal Personnel or Clients

Liaising with customers may be required for any new information needed or in order to seek additional information. Such information may emanate either from bank personnel or from the client. For instance, liaising with the legal officer may be important to obtain a legal opinion on specific credit matters.

Chartered Valuation Surveyor and Architect

The credit analyst must obtain valuation reports to ascertain that the value of the security offered is indeed realistic. Some banks have their own in-house legal cell.

Legal Feedback



Any loan processed should factor in legal considerations. Perhaps the most notable of these is abiding by the Borrower Protection Act 2007.

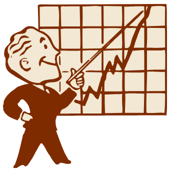
Credit Committee

Approval must be given by the credit committee. Different banks will adopt different types of credit committees within a defined credit-approving power. However, there is convergence in that different credit committees are established to cater for different amounts of the banking facilities. For instance, for loans of an amount of less than Rs 500,000, an amount between Rs 500,000 and Rs 5,000,000 and for any amount above Rs 5,000,000, credit committees A, B, and C will be responsible, respectively. Nowadays, loan approving software is available, which some banks have implemented whereby specific criteria are set as per the bank's internal credit policies.

Disbursement

Post approval and ensuring that security documents have been properly registered or a lien on the fixed deposit receipt has been effected, disbursement can be made. However, the bank also needs to ensure that the borrower abides by all the conditions attached with the loan offer.

Monitoring



It would be fallacious to conclude that the procedures attached to credit processing end when the loan is disbursed. As a matter of fact, there is the need to effect proper monitoring and this is actually the most difficult task embodied in the process. Some banks have adopted annual reviews of all credit facilities to ensure their interests are being protected and also to identify any early-warning signs to prevent impairment.

Handing Over

It is vital to note that different banks will cling to different processing philosophy. It could well be that all these processes are undertaken in one department or a number of departments. For instance, separate departments could be established for monitoring and disbursement.

CHAPTER TWO

SKILLS PREREQUISITE FOR A CREDIT ANALYST

Though this book is not intended for career guidance, I consider it important to say a few words about the skills that good credit analysts should have in order to effectively and efficiently perform their job.

The role of credit analyst is perhaps one of the most interesting as well as the riskiest jobs in this world. Indeed, working as a credit analyst confers some sort of special prestige, because whether or not a customer is able to get a loan will ultimately depend on the final recommendations provided by the credit analyst. Consequently, a certain sense of honor is attached to the role of credit analyst. On the other hand, any errors made by the credit analyst may cause the bank to incur major losses in certain circumstances.

To smoothly perform the job of credit analyst, I believe that certain skills are *sine qua non*. In essence, the most important fact remains that the credit analyst needs to be a person imbued with multi-dimensional skills. First and foremost, communication skills (both verbal and written) are vital to enable the credit analyst to properly deal with customers and also to report to superiors/auditors as and when required. Second, the job demands a relatively high level of analytical skills when assessing company financials, computing ratios, and repayment capacity. Third, there is also the need for proper monitoring skills. As a matter of fact, the most delicate and difficult part of credit management lies in ensuring a sound monitoring process. Fourth, reading skills are also significant since, in at most two readings, the credit analyst should be able to get a complete grasp of the matters concerned. Additionally, reading newspapers on a daily basis or business reports/magazines is also a must for the credit analyst to maintain an enhanced insight into current trends in the field. Fifth, a satisfactory level of observatory skills is also warranted, chiefly in case site visits are necessary to justify end use of funds. Sixth, a high degree of receptive and retentive mind power is also needed since the credit analyst will not only be dealing with financial issues but also with legal issues and others (such as knowing the terms used by chartered valuation surveyors), the business model, management capability, and the industry risks, among others.[1]

It is vital to bear in mind that no one skill is superior since all the skills are required at one or another point in time. Nevertheless, the best way that credit analysts can deliver higher value-added services to their portfolio of clients is to be proactive by generating timely responses. For instance, identifying the business needs of the business through analysis of end-of-year sales and calling on the customer to find out whether the customer is in need of additional funds clearly indicates superior services being delivered. Besides, the customer really will feel the bank is genuinely concerned about the customer's business and not merely charging for facilities provided. As a matter of fact, the Mauritian banking system is highly competitive and the best way that credit analysts can distinguish their bank from others is by constantly delivering superior services to clients. In general, one could consider the credit analyst to be an artist.

[1] At any time, the credit analyst may be conversing with someone from an insurance company, a notary, a chartered valuation surveyor or an attorney-at-law. He needs to have full grasp of all terms found in each case. Above all, the credit analyst should be well conversant with working mechanisms of the following instruments: checks, bill avalization and bill discounting, documentary credits, bank guarantee, money laundering, MCIB, MACSS, SWIFT, TT, and such others.

CHAPTER THREE

CREDIT PROCESSING

3.1 Whole Gamut of Credit Processing Knowledge

Report from a credit analyst as to whether a loan should be granted or not.

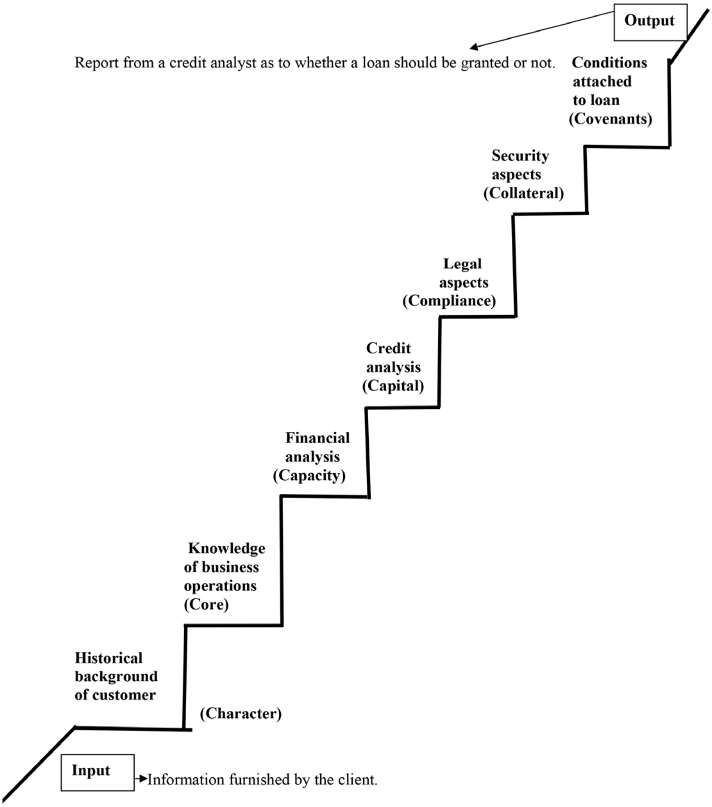


Figure 1. The sphere of the credit processing mechanism reduced to the "seven Cs."

Due to the complexities involved in the sphere of credit processing activities, I have split the whole sphere of credit processing into seven main parts as illustrated in Figure 1. I believe that, with the above figure, the assimilation process will be eased substantially. Indeed, under each part, I have used a new word, with each one starting with the letter "C," viz.:

Historical background of customer	=	Character
Knowledge of business operations	=	Core
Financial analysis	=	Capacity (Chapter 9)
Credit analysis	=	Capital (Chapters 6 and 7)
Legal aspects	=	Compliance
Security aspects	=	Collateral (Chapter 11)
Conditions attached to loan	=	Covenants

As per my experience garnered as a credit analyst, any credit processing request emanating from any financial institution will very likely incorporate the above salient features. However, though the above analysis was designed with corporate cases in mind, for an individual analysis there is no major difference. Knowledge of business operations is now replaced by the employment state of the person. Each of these seven Cs is explained below.

3.1.1 Historical Background of Customer—Character

The level of experience and prior track record of senior management is very important in measuring the potential of an organization. "Character" refers to the degree to which the directors, managers, and shareholders of the private company are really responsible for borrowing and repaying the funds. It constitutes a key factor for borrowing since it addresses the borrower's willingness to pay, irrespective of ability. Usually, any financial institution will assign a small paragraph, dedicated toward describing the experience and expertise of the managers/shareholders of the company. Above all, if the company has already contracted any credit facility[1] and has already settled the loan, the character of management is enshrined and thereby perceived as highly positive. However, other factors—such as a new strategy to be deployed, competitiveness level, or

[1] The term "credit facility" incorporates loans, overdrafts, or any other advance, whether fund based or non-fund based. Fund-based credit facilities are mainly on-balance-sheet items, while non-fund-based facilities are off-balance-sheet items that are also treated as contingent liabilities.

new vision of the company—may also be considered as important ingredients for character assessment.

As for credit for individuals, the process tends to be much simplified since there is no need to report on many persons. Again, the process is eased where the customer has been banking for a long time with the bank. In the same vein, the borrower is perceived as being imbued with sound repayment capacity if the borrower has been solvent for any past loan contracted with the bank.

Perhaps the best way to define character is that the first impression constitutes the last impression. If, at the outset, an applicant's request for a loan is judged to be genuine, this enhances the loan processing task. However, if, at any point in time, the credit analyst finds that something is amiss, this systematically reduces the credibility of the applicant vis-à-vis the bank.

3.1.2 Knowledge of Business Operations—Core

The credit analyst should be conversant with the operational status of distinct types of business in Mauritius. The analysis should always keep abreast with any changes in credit policy of the bank, as well as new acts or regulations. A glaring instance pertains to the budget of 2006/07, whereby the government curtailed its demand for bread to be channeled toward schools. The subsequent reduction in bread supply to schools has engendered a negative effect on the operations of many bakeries in Mauritius. In such cases, a wise credit analyst may endeavor to reappraise the loan period in order to smooth the repayment process. Besides, different types of business may be subject to different states of affairs. For instance, proceeds from sugarcane growers are expected to be routed at some specific time period during the year. Similarly, in the car industry, bank guarantees are needed in favor of the Mauritius Revenue Authority and also in favor of the government of Mauritius. The following points can also be considered as forming part of the core element of the credit processing mechanism, namely:

- Whether the need for a temporary overdraft facility is justified. Past trends should be analyzed to see whether there is any rise in activity in a specific period, which validates the additional working capital needs of the company.

- Whether the business is currently viable or not. What is the future scope of same and will any future change in policy or change in regulatory requirements jeopardize the loan repayment of the company?

- Examine the foreign exchange operations of the business. For instance, if the company is export-oriented, this presents to the bank a potential source of foreign currency. Such a source may be highly useful in case the foreign exchange market is affected by a dearth of foreign currencies.

- Scrutinize checks and record payments to know whether the payments are justified or not. Above all, this may also assist in preventing any money-laundering motives.

- The value of account of the business. Is the credit turnover of the business rising or falling? Are there any kite-flying transactions taking place? How far is the bank benefiting from the foreign exchange transactions of the company?

3.1.3 Financial Analysis—Capacity

Capacity focuses on the cash flow or the ability of the borrower to repay the financial obligation. The capacity, or ability to pay, will undeniably depend on the degree to which the company is generating funds to service interest and principal repayments. However, capacity should be considered as a dynamic variable since many factors affect it, including stringent government price controls, unforeseen event risk, and new competitors in the industry.

Since financial analysis is of paramount significance for any credit proposal, a whole chapter has been dedicated to that. Nevertheless, suffice it to say that capacity assessment is an integral part of any credit processing. For instance, the assessment of repayment capacity is based on computation of the debt service coverage ratio. This ratio assesses the degree to which the company will be able to repay the loan. However, there is also the need to focus on scenario analysis to gauge the degree to which the debt service coverage ratio withstands different economic conditions. Apart from assessing the repayment capacity, financial analysis via ratios is also imperative to understand whether the company is faring well over time. Indeed, it is utterly fallacious to analyze ratios in isolation; they need to be compared, either for the same company over time or vis-à-vis a company sharing similar operations in the same industry. For instance, to know whether the company is solvent in the very short term, the current ratio is computed. Because stocks tend to be illiquid, recourse is made toward the acid-test ratio. Moreover, the profitability state of the company is important. Indeed, the credit analysis should compare the return on the project vis-à-vis the cost of the loan to establish whether the project is lucrative. For example, where a company comprises distinct businesses and the credit analyst identifies one of the businesses as having a poor return, he can advise the company to focus specifically on those lines of business that are highly remunerative.[2] But, it could be that the directors are implementing a sort of predatory pricing in Business A to be able to absorb a higher market share. In the meantime, the other businesses are cross-subsidizing the operations of Business A.

3.1.4 Credit Analysis—Capital

Again, to facilitate the assimilation process, I deemed it apt to use the term "capital" to refer to credit analysis. The rationale is that capital pertains to the level of a customer's stake in the project and the aim of the banker is to see to it that its exposure is well contained under both repayment and security aspects. In addition, limit assessments tend to constitute a preponderant arm of credit analysis. For instance, when a company is seeking an overdraft facility, the credit analyst should assess the limits to establish whether they are justified on the basis of the business operations. In a parallel manner, for any overdraft enhancement, the credit analyst should factor in whether the business is subject to growth sufficient to substantiate such enhancement. Any allied exposure with related parties and strategies deployed by the banker to reduce risk form integrating parts of credit analysis. The difficulty of the task of credit analysis becomes compounded when a group is offering the same securities for all facilities availed by its companies. In that case, an overall assessment is vital. However, it could be stated that credit analyses tend to incorporate almost all of the seven Cs stated above. Indeed, these seven Cs form part of the whole gamut of credit processing such that they will automatically have some say in credit analysis.

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[2] A notable example pertains to Ireland Blyth Limited, which closed its air travel business (Catovair) in the wake of substantial losses incurred in that segment of its businesses.

3.1.5 Legal Aspects—Compliance

Any bank has to perpetually abide by the Bank of Mauritius guidelines pertaining to credit management. Similarly, the bank also has to respect its own internal credit policy. For instance, credit exposure to a single party may not exceed a certain stipulated level. In the same vein, the bank may also have sectoral capitalization in that total advances in a certain sector may not exceed a certain level. Critical limits are also established in cases of related party transactions. Apart from credit policies, banks also need to adhere strictly to anti-terrorism acts and anti-money-laundering acts. Finally, any new act should also be given due consideration like the recently enacted Borrower Protection Act 2007.

3.1.6 Security Aspects—Collateral

The aim behind security analysis is to ensure that the bank has an ample safety net in case things veer off course. However, as a sound credit management process, security should not be the principal focus since security does not act as a perfect substitute for repayment. This is why, under judicious credit analysis, lenders ensure first and foremost that the customer is endowed with a satisfactory repayment capacity and only then do they analyze the security component. The implementation of the Borrower Protection Act 2007 will stimulate banks to now lean more toward ensuring sound repayment capacity of the borrower since the Act benefits borrowers more than lenders.[3] The best assets for collateral are those that are easily tradable. By contrast, assets that have high obsolescence risk, such as fashion or high technology equipment, may provide poor collateral or protection for a loan. In the same vein, assets having a high degree of specificity pose the same level of risk.

Since security analysis is an important element in any credit processing task, again, a separate chapter has been assigned to deal with all its pertinent elements.

3.1.7 Conditions Attached to Loan—Covenants

Covenants pertain to the terms and conditions attached to any loan offer. These terms specify any restriction on management's behavior in a variety of scenarios. For instance, there may be limitations on further indebtedness

[3] Refer to the Borrower Protection Act 2007.

or restrictions on liquidation of key assets without prior approval of the borrower's bank. Some commonly cited conditions attached to a loan are: loan to be disbursed in stages, decreasing term assurance (DTA)/life assurance policy to be assigned in favor of the bank, and comprehensive insurance cover to be taken on new vehicles. Chapter 10 ("Banking Terms and Vocabulary") provides some instances of negative and affirmative covenants.

3.2 Loan Types

It would be improper to write a book on credit matters without giving due consideration to the main types of loans present in the Mauritian banking system. As such, housing, educational, car, and personal loans are discussed in the following sections. To keep abreast with any new developments, investment loans are also considered.

3.2.1 Home Loan (Alternately Labeled as "Housing Loan")

Acquisitions of property, land, or an apartment, and the construction, extension, or renovation of a house all tend to fall under a housing loan scheme. Any refinancing of a home loan also systematically falls under the housing loan scheme. However, though banks differ in their credit policy regarding the financing for a housing loan, there is a common tendency for banks to advance 100% of finance in construction cases, 70% for land acquisition, and 80% for property acquisition. However, the condition attached to the construction loan will be that the loan is disbursed in stages following successive submission of work in progress reports from a reputed chartered valuation surveyor. The distinctive element between a construction loan and a loan for acquisition or renovation purposes is that the former tends to avail a higher number of years, ranging from ten to even twenty-five or thirty, while the latter has a shorter tenor, say a maximum of seven years. However, irrespective of the purpose of the housing loan, the bank will normally ascertain that the borrower's age does not exceed sixty-five years old at any time while the loan is being repaid. This is often ensured by aligning the tenor of the loan with the age of the borrower.

The most important condition attached to the offer pertaining to a construction loan is that the house should be constructed within five years. Again, depending on the bank's credit policy, early repayment options may be available with no costs to be borne. Moreover, during the moratorium period, repayment tilts only toward interest payments. As far as the maximum financing threshold is concerned, this can revolve around Rs 2 million or more for the construction loan. Indeed, some banks may be prepared to advance a higher loan amount subject to the robust repayment capacity of the applicant. For an acquisition, meanwhile, the financing amount will systematically be based on a reputed chartered valuation surveyor's report. For construction loans, a certified construction costs report compiled by the contractor is needed and the bank will usually require the borrower to insure the building against fire and any other allied perils. Banks normally require that applicants provide evidence of a stable source of income and the most obvious security type considered focuses on a first rank fixed charge on property. Some banks may even consider lump sum repayment. Again, depending on the credit policy of the bank, the repayment amount must normally not exceed 40% to 50% of the customer's net monthly income (income less other monthly commitments paid to any financial institution).

3.2.2 Educational Loan

The applied interest on an educational loan tends to be lower than that on a personal loan but somewhat higher than a housing loan. Compared to a housing loan (construction type), the tenor of an educational loan also tends to be much lower. As far as the repayment is concerned, banks show consideration by providing ample options to enhance repayment. For instance, the moratorium period tends to incorporate not only the study time of the course but also the time afterwards spent searching for a job. Meanwhile, the borrower pays interest on the loan. However, for full-time study courses, the parents or relatives of the student should act as borrowers for the loan.

In the same way a loan for the purchase of a new car includes all fees such as registration and VAT, an educational loan is likely to cover all vital fees, apart from the course fees, such as accommodation fees, living expenses, and air travel. Normally, the borrower is allowed to repay the loan until retirement (aged sixty); a maximum age of sixty-five years old may also be considered, should the borrower prove a regular inflow of funds. Again, banks stipulate the need to have insurance cover to ensure the loan gets repaid, should the borrower die or become disabled. Furthermore, depending on yearly need for study fees, the annual disbursement of the loan will follow accordingly. Consequently, any payments made will be a function of the amount already disbursed. Often for an amount of Rs 300,000 or less and depending on the bank's policy, an educational loan may be granted without any fixed charge but subject to the personal guarantee of the borrowers, which are usually the parents or relatives of the student. However, based on the large exposure, banks will normally seek tangible securities for the loan such as a fixed charge on property. As part of the documentation required, proof of registration and acceptance from a recognized university are essential. A letter of acceptance and confirmation of total course fees pertaining to the awarded course should also be furnished to the bank.

3.2.3 Car Loan

The maximum repayment time period allowed for a car loan is normally around five to seven years (maximum). For new car financing, the tenor of the loan can even reach ten years while for second-hand or reconditioned cars, the permissible loan period tends to be at most five years. However, this depends on the respective credit policy of the bank. As security, the bank will normally have recourse toward a *gage sans deplacement* on the vehicle or it may consider any other types of security, whether fixed charge, floating charge, or fixed deposit receipt. However, where a fixed deposit receipt is offered as security, the customer will normally be eligible for a better interest rate. The fixed deposit receipt should be pledged in favor of the bank. The benefit of the fixed deposit receipt is that the customer is not compelled to take out any life assurance policy to cover the loan repayments in case of disability or death. Basically, the banker will insist on receiving the quotation price of the vehicle to gauge the amount of financing required. Indeed, banks will not provide 100% financing; they often agree to finance about 70% of the quotation price of the new vehicle (inclusive of VAT and registration fees). However, again, banks differ in their credit policy pertaining to car financing. Some may be willing to finance a higher level for new cars (say 75%) while others may be willing to finance only 60% for second-hand or reconditioned cars. Nevertheless, the main point of concern is related to comprehensive insurance policies whereby a car older than ten years normally will not be entitled to a comprehensive insurance scheme.

3.2.4 Personal Loan

Irrespective of the bank's respective credit policy, there is general tendency for interest rates on personal loans to exceed that on housing or educational loans. Indeed, the interest rate tends to be Prime Lending Rate

(PLR) plus 4%, 5%, or even 6%, again, all depending on the credit policy of the bank. Another important characteristic of personal loans is that the amount is susceptible to being linked to either the borrower's net or gross salary. For example, one bank may deem fifteen times net salary as the eligible amount for the personal loan while another bank may consider only twelve times the gross salary. Usually, the maximum repayment period is six years, but it all hinges on the credit policy of the bank and the eligibility requirements tend to be biased toward a minimum monthly income of Rs 10,000 with the borrower being in confirmed employment. For a certain threshold amount of personal loan, the loan may consider only salary pledge and personal guarantee as part of security documentation along with the required life assurance or DTA cover to insure loan repayments against any unforeseen contingencies affecting the borrower. However, for larger personal loans, the bank will inevitably have recourse toward a fixed charge on a tangible security.

3.2.5 Investment Loan

To lure more customers, some banks even provide loans for the purchase of shares. The applied interest rate on such loans is usually lower than that of personal loans, say PLR plus 3%. The security considered would normally be a pledge of the shares bought, whereby such a pledge should be assigned in favor of the bank. However, the bank, as a precautionary measure, will be reluctant to finance 100% of the costs related to the purchase of the shares. Normally, the bank will consider a debt–equity ratio of 1:1; i.e., a 50% stake in the investment by the bank and not more, the difference of which acts as a margin cover, bearing in mind the volatile state of share prices. In addition, the bank may also waive any early repayment fees, should the loan be settled prematurely. The rationale is that, at any time, the investment loan transferred into a portfolio of securities may generate such considerable gains as to stimulate the buyer to sell the shares, converting unrealized gains into realized ones.

3.2.6 Corporate Loans

Corporate loans are loans that are chiefly taken by companies in view of expanding their business activities. These types of loans tend to be very complex and highly risky bearing in mind that companies avail of limited liability status.