Loans and Securities

Basic Ideas

Bank and Customer

- In the previous class we spoke of Bank and Customer.
- Deposits and Loans
- Banks and NBFCs
- Many types of customers
- The relationship (generally) – Debtor and Creditor
- Loan from the bank/financial institution can make a difference to the business/activity.
- Contract (!)

Laws governing the field

- RBI Act, 1934
- BR Act, 1949
- SARFESI Act, 2002
- Indian Contract Act, 1872
- Transfer of Property Act, 1882
- FEMA 1999
- Companies Act, 2013
- IBC, 2016 (!)

Credit Portfolio

- A bank’s credit portfolio comprise of Loans and Advances
- Automobile loan, home loan etc --- Overdraft, Cash credit etc
- Differences – Nature, Legal formalities, etc
- Remember, bank gives out credit from the deposits collected – Restrictions are needed.
- Own money v. Other’s money

Principles of Lending

- Safety
- Liquidity
- Profitability
- Purpose
- Diversification / Spread
- Security

Kinds of Lending

- Bilateral
- Consortium
- Syndicated
- Priority

Kinds of Borrowers

- Individuals, Firms, Companies, MNCs, MSMEs, SHGs, etc
- Retail
- Corporate

Can loan be given to anyone?

- What to look for?
- Generally, 5 Cs
- Character
- Capacity
- Capital
- Collateral
- Condition

Different Kinds of Loans

- Fund-based versus Non-fund based loans
- Retail versus Commercial or wholesale lending
- Collateralised versus Uncollateralised lending, i.e., Secured versus Unsecured loan
- Domestic loans versus External commercial borrowings
- Term loan versus Working capital loan
- Bilateral loan versus Syndicate loan
- Project finance lending

Fund Based and Non- Fund Based

- Demand Loan
- Term Loan
- Overdraft
- Cash Credit
- Buyer’s Credit
- Supplier’s Credit
- Hire-Purchase
- Non Fund – BG, LC etc

Bank Guarantee

- Generally we hear about these in Tenders.
- Banks are often required to issue guarantees on behalf of their customers.
- A bank guarantee ensures that the liabilities of the debtor will be met in the event he fails to fulfil his contractual obligations.
- General types - Financial, Performance, Deferred Payment

Letter of Credit

- Also known as Documentary Credit
- A payment mechanism used specially in international trade. UCP 600
- Generally, buyer’s bank undertakes to make payment to seller on production of documents stipulated in the document of LC
- Types – Revocable/Irrevocable, Transferable, Confirmed/Unconfirmed etc
- Parties:
  - Applicant/ Opener
  - Issuing Bank
  - Beneficiary
  - Advising Bank
  - Confirming Bank, Negotiating Bank, Paying Bank/ Nominated Bank, Reimbursing Bank

Security

- In lending, ‘security’ refers to proprietary or possessory rights over a borrower’s or third party’s assets that a bank can exercise to repay a loan if the borrower defaults.
- Security creation aims to protect the creditor by providing an additional means of obtaining payment, especially in cases of the debtor’s insolvency or unwillingness to repay.
- A security interest refers to a lender’s claim on an asset, while securities are tradable financial instruments, and securitisation involves converting loans into marketable securities.

How to identify a good security?

- MASTDAY Principle
- Marketability
- Ascertainability
- Stability
- Transferability
- Durability
- Absence of Contingent Liability
- Yield

Types of Security Arrangement

- Mortgage
- Hypothecation
- Pledge
- Lien
- Assignment
- Charge

Types of Mortgage

- Simple
- Usufructuary
- Conditional sale
- English
- Deposit of title deeds