

**INSTITUTE OF BANKERS IN MALAWI**

**ADVANCED DIPLOMA IN BANKING EXAMINATION**

**SUBJECT: CREDIT RISK ASSESSMENT 2 (IOBM-AD303)**

**Date: Sunday, 11th November 2018**

**Time Allocated: 3 hours (08:00 – 11:00 Hours)**

**INSTRUCTIONS TO CANDIDATES**

1 This paper consists of **TWO** Sections, A and B.

2 Section A consists of 4 questions, each question carries 15 marks.

Answer **ALL** questions.

3 Section B consists of 4 questions, each question carries 20 marks. Answer **ANY TWO** questions.

4 You will be allowed **10 minutes** to go through the paper before the start of the examination, you may write on this paper but not in the answer book.

5 Begin each answer on a new page.

6 **Please write your examination number on each answer book used. Answer books without examination numbers will not be marked.**

7 All persons writing examinations without payment will risk expulsion from the Institute.

8 If you are caught cheating, you will be automatically disqualified in all subjects seated this semester.

9 DO NOT open this question paper until instructed to do so.

**SECTION A (60 MARKS)**

Answer **ALL** questions from this section

**QUESTION 1**

Your client with outstanding credit facilities has requested to replace the existing security comprising of mortgage over their head office and warehouse. What are the disadvantages of taking the following as new security?

1. Cession of book debts. *(3 marks)*
2. Cession of shares in companies. *(3 marks)*
3. Cession of retention money.  *(3 marks)*
4. Cession of Policy. *(3 marks)*
5. Pledge of stock/merchandise.  *(3 marks)*

**(Total 15 marks)**

**QUESTION 2**

As a Credit Manager for your bank you have been allocated new members of staff that need orientation on credit risk management issues and you are supposed to briefly describe how the following variables affect credit risk:

**Required**

1. The credit policy of the bank. *(5 marks)*
2. Employees of the bank. *(5 marks)*
3. Credit management and control systems. *(5 marks)*

**(Total 15 marks)**

**QUESTION 3**

Discuss any **two** structures of negotiations from a banker's perspective supported by an example of a situation in which any of the two structures of negotiation can apply.

**(Total 15 marks)**

**QUESTION 4**

A well-known and affluent business owner who is considered as very successful in business circles has submitted an application to enable him acquire a chain of lodges. The historical financial statements of the lodges show that they are a viable line of business that will add value to the entire chain of businesses for the client. Enquiries made with the bank where accounts for the lodges are maintained confirmed that the lodges operate accounts with significant credit balances.

The individual has banked with you for a period of over five years and has been granted a number of credit facilities in the past including existing facilities whose loan repayments are usually in arrears while the current account which has an overdraft limit usually operates in excess of the approved limit especially during month end when the business is paying salaries and major suppliers.

The business has enjoyed very good contracts over the five-year period they have banked with you but a significant proportion of revenues especially those paid in cash are not channelled through the account in your bank and after reviewing statements from other banks where the customer has accounts, there is no evidence that such revenues are deposited there. It is rumoured that the client is making other investments using business revenues that should have been channelled to the bank to service existing credit facilities.

At the date of the meeting, the client was driving a Mercedes Benz 2018 Model which he boasted to have bought on cash basis.

Prior to renewal of the company's credit facilities recently the bank obtained references from various stakeholders. Client has outstanding facilities of lower amounts at two other banks whose repayment period was extended recently as there were huge arrears. Both Banks however provided a positive report for the customer. Two other banks excluding the ones where the client has loans made enquiries about the client at the credit reference bureau before the client approached you with the current request. Two major suppliers to the company reported reduced sales on credit basis due to delayed settlement of accounts by the company recently.

**Required:**

Critically assess the credit application with special focus on assessing the willingness of the borrower to pay clearly stating the category under which your comments fall.

**(Total 15 marks)**

**SECTION B (40 MARKS)**

Answer ANY **TWO** questions from this section

**QUESTION 5**

You have joined a new bank as a Senior Credit Risk Manager tasked with determination of the bank's credit appetite. You have been reliably informed that the new bank ceased acceptance of guarantees to secure credit facilities to corporate customers.

1. Briefly discuss the following:
2. **Three** characteristics of guarantees as security for credit facilities. *(6 marks)*
3. The form of a guarantee. *(4 marks)*
4. The phrase, guarantees are not *uberrrimae fidel* and how do banks normally approach such issues. *(3 marks)*
5. Mention any **three** disadvantages of relying on guarantees as security for credit facilities and how any of the **three** shortfalls can be mitigated. *(7 marks)*

**(Total 20 marks)**

**QUESTION 6**

1. Briefly discuss any **two** common forms of mortgage finance. *(6 marks)*
2. Discuss the **two** agreements that are included in instalment credit. *(8 marks)*
3. Briefly define the following forms of credit facilities:
4. Long Term Foreign Loans. *(3 marks)*
5. Project Finance. *(3 marks)*

**(Total 20 marks)**

**QUESTION 7**

1. Briefly define a mortgage and discuss the **three** types of mortgages available to banks as security. *(12 marks)*
2. Our client has submitted an application for a loan facility that will be secured by a mortgage over the client's property within the city.

**Required**

Mention any **four** issues/conditions that you would need to confirm/establish regarding the property prior to creating the mortgage. *(8 marks)*

**(Total 20 marks)**

**QUESTION 8**

Your corporate client, Bows Ltd have applied for a loan facility to finance purchase of an existing company, Stars Ltd that ~~is~~ manufactures and distributes textiles.

The financial statements for Stars Ltd for the past financial year are as follows:

**Balance Sheet of Stars Ltd as on 31/12/2017**

**ASSETS KWACHA**

Non - current assets

\*Fixed Assets 35,000,000

\*Net Current Assets 22,000,000

Total assets **57,000,000**

**EQUITY AND LIABILITIES**

\*Ordinary Shareholders Funds 42,000,000

\*Long Term Loans 15,000,000

Total equity and liabilities **57,000,000**

**Income Statement of Stars Ltd for the year ended 31/12/2017**

**KWACHA**

Revenue 85,000,000

- Cost of Sales (45,000,000)

Gross Income 40,000,000

- Operating Expenses (18,000,000)

Income before interest and tax 22,000,000

- Interest on long term loans (10%) (1,500,000)

Income before tax 20,500,000

- Tax (30%) (6,150,000)

Net Income after tax 14,350,000

**Required**

1. Assuming that the net income will remain constant for the foreseeable future and that cost of ordinary share capital will remain at 14% for the foreseeable future, calculate the current market value of Stars Limited clearly showing the formula used. *(6 marks)*
2. Assuming that Bows Ltd require a rate of return of 13% on the investment and the projected average net income for the foreseeable future is MK16,000,000 per year, calculate the Total Market value of the business. *(6 marks)*
3. Although bankers are encouraged to revalue assets of a business, such revaluation impacts the ratio analysis results. Briefly discuss how revaluation impacts the following ratios:

(i) Return on assets. *(2 marks)*

(ii) Return on Equity. *(2 marks)*

(iii) Turnover of Fixed Assets. *(2 marks)*

(iv) Financial Leverage. *(2 marks)*

**(Total 20 marks)**

**END OF EXAMINATION PAPER**