BANK ANALYSIS

Loan Process and Terms

A bank´s credit culture drives its lending activity as well as its risk management chain: This comprises business development, credit analysis, credit execution, monitoring and administration as well as loan work-out and restructuring, if required.

Prior to extending a loan to a client, extensive credit analysis is undertaken: This, in essence, assesses the likelihood or risk of a client´s default on the loan. The most relevant areas of commercial risk analysis include the risks inherent in the operations of a business, the borrower´s management abilities to address or mitigate such risks, and the lender´s alternatives to adequately structure and control its own exposure.

In this regards, lenders usually refer to the 5 C´s to evaluate a borrower:

- Character: A borrower´s reputation or track record for repaying debts
- Capacity: A borrower´s ability to repay a loan in view of his debt vs income
- Capital: The borrower´s contribution towards a potential investment
- Collateral: Assurances that in the case of default the lender can repossess previously agreed upon borrower´s assets
- Conditions: Terms, such as interest rate, amount of principle, payback schedule, currency or else

The loan decision as such is depending on loan volume and complexity and either be done by an individual officer or a credit committee.

The loan agreement is a legal document, comprising among others:

- Type of credit facility: secured (collateral in case of default) vs unsecured (no collateral)
- Amount
- Currency
- Purpose: working capital, investment, acquisition; overdraft, credit line
- Interest: floating (benchmark) vs fixed, spread
- Payment terms: interest (regular vs accrued), principle (term loan / regular, period payments vs balloon payment, revolving loan where principle can be spent, repaid and spent again)
- Maturity
- Other: guarantors, recourse, reporting and documentation, representations and warranties, events of default

Covenants are an essential part of a loan agreement: Financial covenants are restrictions based on specific balance sheet, income statement or cash flow items, whilst operating activity covenants dictate how to operate a business. Other covenants may refer to reporting, disclosures, maintenance of collateral, restrictions on investments or the payment of dividends, the sale of assets or divestitures.

Often covenants are defined in the form of financial ratios, such as certain minimum standards in regards to liquidity ratios (current or quick ratio), leverage (debt / equity, assets / equity), or profitability (frequently based on cash flow or EBITDA). Covenants can also be distinguished into positive ones (affirmative: what has to be achieved or done) and negative ones (what is not allowed to do).

The loan review process is usually split into monitoring the performance of existing loans and the handling of problem loans. Thereby, the ongoing loan review should act independently of loan officers. – In the case of default (violation of covenants or failure to make agreed upon payments) a loan would be referred to a specialist work-out and restructuring team.

LOAN PROCESS

INITIATIVE / MARKETING → MANDATE EVALUATION →
→ ANALYSIS → APPROVAL → LOAN NEGOTIATION →
LOAN AGREEMENT → DISBURSEMENT → MONITORING