

## Q1.

(a) **What is the primary relationship between a banker and his customer? What additional obligations come with this special relationship?**

The primary relationship between a banker and a customer is that of **debtor and creditor**. When a customer deposits money into a bank account, the bank assumes the role of debtor, owing the customer an equivalent sum, and is obligated to repay the deposited amount upon demand.

In addition to this primary relationship, several other obligations arise from the banker-customer relationship:

1. **Duty of Care:** Banks are required to exercise reasonable care and skill in handling customers' transactions and safeguarding their funds. This includes verifying the authenticity of payment instructions and protecting against unauthorized access.
2. **Fiduciary Duty:** In certain circumstances, such as when managing trust funds or acting as custodians, banks owe fiduciary duties to their customers. This means acting in the best interest of the customer, avoiding conflicts of interest, and not profiting from the relationship without the customer's consent.
3. **Duty to Honor Customer Instructions:** Banks are generally obligated to follow the legitimate instructions of their customers, provided these instructions are clear and within the scope of the account's terms. However, if a bank suspects that a payment instruction is fraudulent or unauthorized, it may have a duty to inquire further before proceeding.
4. **Duty of Confidentiality:** Banks must maintain the confidentiality of their customers' financial information and transactions, disclosing such information only with the customer's consent or when required by law.

These obligations collectively ensure that banks manage customer relationships with trust, integrity, and adherence to legal and ethical standards.

**(b) What is Cash Credit? Briefly describe the different modes of cash credit.**

Cash credit is a short-term loan facility provided by banks to businesses, enabling them to withdraw funds up to a pre-approved limit to meet their working capital requirements. This arrangement ensures that businesses can manage day-to-day operational expenses, such as purchasing materials or paying suppliers, even if their current account balance is insufficient.

**Modes of Cash Credit:**

1. **Overdraft Cash Credit:** This mode is linked to a business's current account, allowing the account holder to withdraw more money than is available, up to a pre-approved limit. It's particularly useful for managing short-term cash flow mismatches and unexpected expenses. Interest is charged only on the overdrawn amount.
2. **Demand Loan Cash Credit:** In this arrangement, the bank provides a loan that is repayable on demand. The borrower can withdraw funds up to the sanctioned limit, and the loan is typically secured against collateral. Interest is charged on the utilized amount.
3. **Special Purpose Cash Credit:** This type of cash credit is extended for specific purposes, such as financing the purchase of raw materials or meeting other operational needs. The loan is usually secured and comes with terms tailored to the specific requirement.

Each mode of cash credit serves different business needs, and the choice depends on factors like the purpose of the loan, repayment terms, and the financial structure of the business. It's essential to assess these factors carefully when opting for a cash credit facility.

**(c) Why is credit planning important for banks? What factors should a bank consider for effective credit planning?**

**Importance of Credit Planning for Banks:**

Effective credit planning is essential for banks to manage their lending activities, balancing profitability with prudent risk management. It involves assessing credit demand, setting appropriate lending limits, and implementing policies to maintain a healthy loan portfolio. This process aids banks in identifying and mitigating potential credit risks by evaluating borrowers' creditworthiness, thereby reducing the likelihood of defaults. Strategic credit distribution also allows banks to optimize capital allocation, ensuring compliance with regulatory capital requirements while maximizing returns. Additionally, proper credit planning ensures that banks maintain adequate liquidity levels, balancing the need to lend with the necessity of having sufficient cash reserves to meet operational needs. Aligning credit offerings with market demand and the bank's risk appetite enables competitive interest rates and terms, attracting quality borrowers and enhancing profitability.

**Factors to Consider for Effective Credit Planning:**

1. **Market Demand Analysis:** Understanding current and projected credit demand helps banks tailor their lending products to meet market needs effectively.
2. **Credit Risk Assessment:** Evaluating the creditworthiness of potential borrowers involves analyzing financial health, repayment capacity, and collateral quality to minimize default risks.
3. **Regulatory Compliance:** Staying abreast of regulatory guidelines and ensuring that credit policies align with legal requirements is crucial to avoid penalties and maintain operational integrity.
4. **Economic and Industry Trends:** Monitoring economic indicators and industry-specific trends aids in forecasting credit demand fluctuations and adjusting lending strategies accordingly.
5. **Operational Capacity:** Assessing internal resources, including staffing and technological infrastructure, ensures that the bank can process and manage loans efficiently without compromising service quality.

By integrating these considerations into their credit planning processes, banks can achieve a balanced approach to growth, risk management, and customer satisfaction.

Q2.

a) Briefly describe the borrower selection process.

The borrower selection process typically involves several steps to evaluate the creditworthiness and suitability of potential borrowers. Here's a brief overview:

1. **Application Submission:** The borrower submits an application, providing details like income, employment, financial status, and loan purpose.
2. **Credit Check:** Lenders assess the borrower's credit history, checking their credit score to gauge their financial reliability and ability to repay.
3. **Income and Debt Evaluation:** The lender reviews the borrower's income, existing debts, and financial obligations to ensure they can handle additional debt.
4. **Collateral Assessment** (if applicable): If the loan requires collateral, the lender assesses its value to secure the loan.
5. **Risk Assessment:** The lender analyzes all gathered information, applying risk models and guidelines to determine the likelihood of default.
6. **Approval or Rejection:** Based on the evaluation, the borrower is either approved or rejected for the loan. If approved, terms and conditions are offered.

This process helps lenders make informed decisions while minimizing risk.

b) What are the uses of Internal Credit Risk Rating System?

The **Internal Credit Risk Rating System (ICRRS)** is a tool used by financial institutions to assess the creditworthiness of borrowers and manage risks associated with lending. Here are its key uses:

1. **Credit Risk Assessment:** It helps evaluate the likelihood of a borrower defaulting on their loan by assigning a risk rating based on various factors like financial health, credit history, and industry risk.
2. **Loan Pricing:** The risk rating influences the interest rate and terms of the loan. Higher risk borrowers may face higher interest rates to compensate for the risk.
3. **Portfolio Management:** Banks and financial institutions use the system to manage their loan portfolios, identifying areas with high credit risk exposure and taking necessary actions to mitigate it.
4. **Regulatory Compliance:** It aids institutions in meeting regulatory requirements, such as capital adequacy ratios and risk-based capital standards, by assessing and quantifying credit risk.
5. **Loan Approval Decisions:** The system supports decision-making in the loan approval process by providing a standardized way of assessing the borrower's credit risk.
6. **Credit Limit Setting:** Based on the rating, financial institutions can establish appropriate credit limits, ensuring that loans are within manageable risk parameters.

7. **Stress Testing:** It allows banks to simulate various adverse economic scenarios to evaluate how credit portfolios might perform under stress, helping in proactive risk management.
8. **Risk Reporting:** It provides a systematic way of categorizing and reporting credit risk levels, facilitating better risk monitoring and reporting to senior management and regulators.

Overall, the system improves decision-making, enhances risk management, and helps institutions operate efficiently while complying with regulatory standards.

### c) What are the stages of credit investigation?

The **credit investigation** process is a thorough evaluation of a borrower's creditworthiness, aimed at minimizing the lender's risk. Here are the typical stages involved:

1. **Application Review:**
  - The borrower submits a loan application, providing details like personal information, income, employment, existing debt, and loan purpose. This stage involves verifying the completeness and accuracy of the application.
2. **Identity Verification:**
  - The lender verifies the borrower's identity through official documents (e.g., passport, ID card) to ensure the borrower is legitimate.
3. **Credit History Check:**
  - A thorough review of the borrower's credit report is conducted to assess their past borrowing behavior, payment history, and current credit score. This helps evaluate the risk of default.
4. **Income and Employment Verification:**
  - The lender confirms the borrower's income and employment status through paylips, tax returns, or employer verification. This helps assess the borrower's ability to repay the loan.
5. **Debt-to-Income Analysis:**
  - The lender calculates the borrower's debt-to-income ratio, comparing their existing debt obligations to their income. This helps determine their capacity to manage new debt.
6. **Collateral Evaluation (if applicable):**
  - If the loan requires collateral, the lender evaluates the value and condition of the assets to determine their adequacy in securing the loan.
7. **Financial Stability Assessment:**
  - The lender may analyze the borrower's savings, investments, or other financial assets to evaluate long-term financial stability.
8. **Risk Assessment and Scoring:**
  - Based on all gathered data, the lender assigns a credit score or rating to assess the risk level. This stage often involves using internal or external risk models.
9. **Approval or Denial:**

- After evaluating all the information, the lender decides whether to approve or deny the loan application. If approved, loan terms and conditions are set.

**10. Documentation and Agreement:**

- If the loan is approved, the borrower and lender sign a loan agreement that outlines the terms, conditions, and repayment schedule.

Each stage aims to ensure that the lender has a comprehensive understanding of the borrower's financial situation to make an informed lending decision.

Q3.

a) What are the causes of standalone Credit Risk? 6

Standalone credit risk arises from factors specific to an individual borrower. Key causes include:

1. **Borrower's Creditworthiness:** Poor financial health or history of defaults.
2. **Income Instability:** Unpredictable or insufficient income.
3. **Poor Financial Management:** Overspending or mismanaging finances.
4. **High Debt Levels:** Excessive debt compared to income.
5. **Credit History:** Previous defaults or missed payments.
6. **Industry Exposure:** Dependence on a vulnerable sector.
7. **Lack of Collateral:** No asset backing the loan.
8. **Legal/Regulatory Issues:** Ongoing legal or compliance problems.
9. **Personal Factors:** Life changes like illness or divorce.
10. **Lender Overexposure:** Excessive lending to one borrower.

These factors increase the risk that the borrower will fail to repay the loan.

b) Describe the general steps to manage Credit Risk in a bank.

Managing credit risk in a bank involves the following key steps:

1. **Credit Risk Identification:**
  - Identify potential risks from borrowers, industries, or sectors that could affect repayment.
2. **Credit Risk Assessment:**
  - Evaluate borrower creditworthiness using credit scores, financial analysis, and credit history.
3. **Risk Appetite and Policies:**
  - Set lending limits and guidelines in line with the bank's risk appetite and regulatory requirements.
4. **Credit Approval and Collateral:**
  - Implement a thorough approval process and secure loans with collateral or guarantees.
5. **Monitoring and Reporting:**
  - Continuously track loan performance and borrower financial health.
6. **Risk Mitigation and Stress Testing:**
  - Use diversification, hedging, and stress tests to evaluate portfolio resilience under adverse conditions.
7. **Provisioning and Review:**
  - Set aside provisions for potential losses and periodically review credit risk strategies to adjust for market changes.

These steps help banks manage and minimize credit risk, ensuring financial stability

### c) What are the different aspects of credit appraisal?

Credit appraisal involves assessing a borrower's ability to repay a loan and evaluating the risk involved. The key aspects of credit appraisal are:

1. **Creditworthiness:**
  - Assessing the borrower's financial history, credit score, and past repayment behavior.
2. **Income and Employment Stability:**
  - Evaluating the borrower's income, employment status, and job stability to determine repayment capacity.
3. **Debt-to-Income Ratio:**
  - Calculating the borrower's existing debt obligations relative to their income to assess their ability to handle additional debt.
4. **Collateral Evaluation:**
  - Assessing the value and adequacy of assets provided as collateral to secure the loan.
5. **Cash Flow and Financial Health:**
  - Reviewing financial statements, bank statements, and other documents to evaluate the borrower's cash flow, savings, and overall financial condition.
6. **Purpose of Loan:**
  - Understanding the purpose of the loan to ensure it aligns with the borrower's financial goals and risk profile.
7. **Industry or Sector Risk:**
  - Assessing risks associated with the borrower's industry or sector, which might affect their financial stability.
8. **Legal and Compliance Check:**
  - Verifying the borrower's legal standing, including checking for any existing liabilities or legal disputes.

These aspects help lenders make informed decisions about whether to approve or deny the loan application.



Q4.

a) Why the insurance coverage of the security is important? -6

Insurance coverage of the security is important because it helps protect the lender's interests in case the collateral is damaged, lost, or destroyed. Without insurance, the lender may face a significant financial loss if the secured asset, such as property or equipment, becomes unavailable or diminished in value. Insurance ensures that the asset's value is preserved, allowing the lender to recover the loan amount or part of it in case of unforeseen events. It also provides the borrower with added security, as the insurance helps safeguard both their financial stability and the lender's risk exposure.

b) Describe the significance of timely loan recovery? -6

Timely loan recovery is crucial for both the lender and the borrower, as it has far-reaching implications for the overall financial stability of the lending institution and the borrower's future creditworthiness.

For the lender, timely recovery ensures a consistent and stable cash flow, allowing them to meet their own financial obligations, such as operational costs and regulatory capital requirements. This steady flow of funds also enables the lender to reinvest in new loans, continuing the lending cycle and fostering growth. When loans are repaid on time, the lender can avoid the negative consequences of overdue or non-performing loans, which can significantly erode profitability and create financial strain.

Furthermore, timely loan recovery helps in managing credit risk effectively. When loans are paid as scheduled, the lender can avoid a buildup of bad debt and reduce the need to pursue costly collection efforts. Defaulted loans can lead to high provisions for bad debts, which may impact the bank's overall financial health and affect its credit rating. It also prevents unnecessary administrative costs and the need for legal actions, both of which can be time-consuming and expensive.

From a borrower's perspective, making timely loan payments is crucial for maintaining a positive credit history and improving their creditworthiness. A consistent repayment record boosts the borrower's chances of securing future credit at favorable terms, such as lower interest rates or higher loan amounts. On the other hand, late or missed payments can damage the borrower's credit score, making it more difficult to obtain financing in the future.

Timely loan recovery also helps maintain the relationship between the borrower and the lender. It fosters trust and ensures that both parties can rely on each other in future financial transactions. For the borrower, meeting repayment deadlines demonstrates financial discipline and responsibility, which can be important when seeking additional financial products or negotiating terms.

In summary, timely loan recovery plays a pivotal role in maintaining a healthy financial ecosystem for both the lender and borrower. It supports the lender's profitability, strengthens risk management practices, and ensures the borrower's financial reputation remains intact, leading to better opportunities for both parties in the future.

### c) What are the non-legal measures of recovering Non-Performing Loan (NPL)?-8

Non-legal measures for recovering Non-Performing Loans (NPLs) focus on approaches that do not involve legal action but still aim to recover the outstanding debt. These measures are generally less costly and time-consuming compared to legal proceedings. Some common non-legal measures include:

#### 1. **Restructuring the Loan:**

- The lender may negotiate with the borrower to restructure the loan by extending the repayment period, reducing interest rates, or offering a temporary grace period. This makes the loan more manageable for the borrower and increases the chances of recovery.

#### 2. **Debt Rescheduling:**

- Similar to restructuring, debt rescheduling involves modifying the loan terms, including altering the repayment schedule to accommodate the borrower's current financial capacity, making it easier for them to meet repayment obligations.

#### 3. **Payment Plan Negotiation:**

- A repayment plan can be worked out based on the borrower's ability to pay. The lender may offer smaller, more frequent payments over a longer period of time to help the borrower get back on track.

#### 4. **Forbearance:**

- In this case, the lender may temporarily suspend or reduce loan repayments to give the borrower time to improve their financial situation. This is often used for borrowers facing temporary financial distress, such as job loss or business downturn.

#### 5. **Debt Settlement:**

- The lender may agree to accept a reduced payment as full settlement of the debt. This is usually offered if the borrower is unable to repay the full loan amount, but the lender agrees that a partial repayment is better than no payment at all.

#### 6. **Resale of Collateral:**

- If the loan is secured, the lender may sell the collateral (e.g., property or assets) to recover the outstanding loan balance, rather than going through a formal foreclosure process.
- 7. **Debt Recovery through Collection Agencies:**
  - Lenders may hire third-party debt collection agencies to pursue the borrower for payment. These agencies specialize in recovering overdue loans and may use various negotiation techniques to reach a settlement or arrange payment plans.
- 8. **Voluntary Surrender of Collateral:**
  - The borrower may voluntarily return the collateral to the lender in exchange for the cancellation of part or all of the remaining loan balance, which can be an alternative to more formal legal recovery.
- 9. **Communication and Negotiation:**
  - Maintaining open communication with the borrower and negotiating a solution is a critical non-legal method. By discussing the financial difficulties and working with the borrower, lenders can sometimes find mutually agreeable terms for loan recovery.

These non-legal methods aim to resolve the debt in a way that benefits both the lender and the borrower, avoiding the lengthy and expensive process of legal action.

Q5.

a) What do you mean by Break-Even Point? Show it graphically.-5

**Break-Even Point (BEP)** is the point at which total revenue equals total costs, meaning there is neither profit nor loss. It is the level of sales at which a business covers all of its fixed and variable costs. Once sales exceed the break-even point, the company begins to make a profit.

The formula to calculate the break-even point in units is:

$$\text{Break – Even Point (units)} = \frac{\text{Fixed Costs}}{\text{Price per Unit} - \text{Variable Cost per Unit}}$$

Where:

- **Fixed Costs** are the costs that do not change regardless of the level of production or sales (e.g., rent, salaries).
- **Price per Unit** is the selling price of each unit of the product.
- **Variable Cost per Unit** is the cost that changes with the level of production (e.g., raw materials, direct labor).

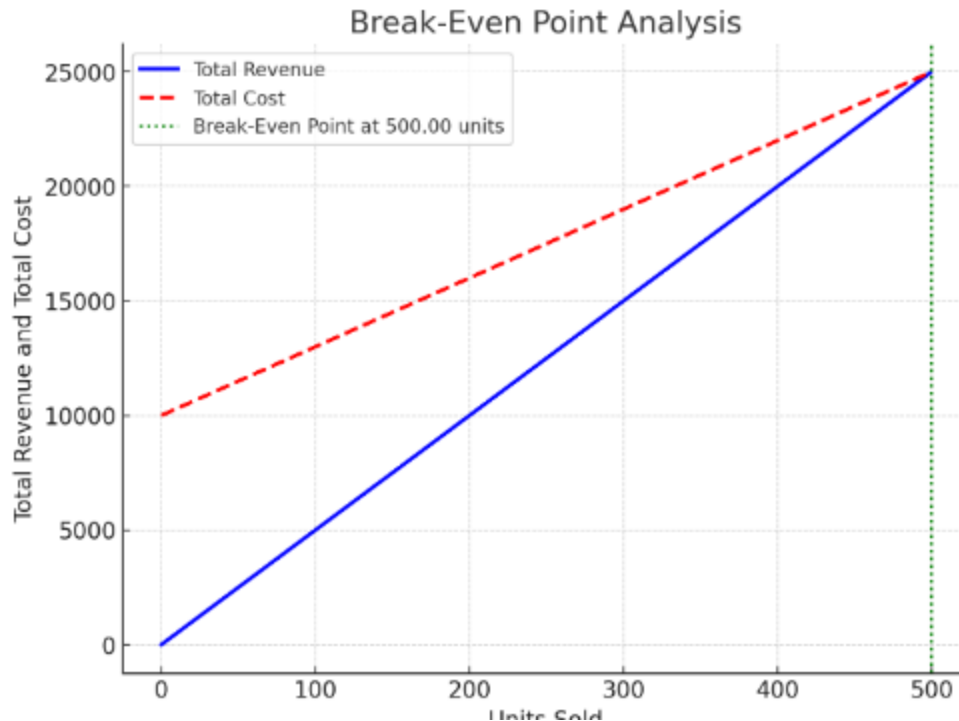
Graphical Representation:

The graph of the break-even point typically includes:

- **X-axis** representing the number of units sold.
- **Y-axis** representing total revenue and total costs.
- The **Total Revenue Line** starts at the origin and increases with sales.
- The **Total Cost Line** starts from the fixed cost level and increases with the number of units sold (due to variable costs).

The point where the **Total Revenue Line** intersects the **Total Cost Line** is the break-even point. At this point, the company is neither making a profit nor incurring a loss.

Let me show you the graph.



The graph above illustrates the break-even point. The blue line represents the **Total Revenue**, which increases as the number of units sold increases. The red dashed line represents the **Total Cost**, which starts at the level of fixed costs and increases as production rises, due to variable costs.

#### b) What are the limitations of Cost-Volume-Profit (CVP) analysis?-5

Cost-Volume-Profit (CVP) analysis is a useful tool, but it has several limitations:

1. **Linear Assumption:** CVP assumes that both costs and revenues are linear, which may not hold true in real-world situations where costs and revenues can vary with economies of scale or other factors.
2. **Fixed Costs:** CVP assumes fixed costs remain constant, but they can change with capacity expansions, scaling, or other operational adjustments.
3. **Single Product Focus:** Many CVP models assume a single product or constant product mix, which doesn't apply to businesses with multiple products, each having different cost structures.
4. **Variable Cost Simplification:** It uses a simplified approach to variable costs, potentially overlooking complex cost behaviors like semi-variable costs (e.g., overtime pay).
5. **Market Conditions:** CVP doesn't account for external factors like competition or market changes, which can influence sales and profitability.
6. **Constant Price Assumption:** It assumes the selling price remains stable, which may not be realistic in competitive or fluctuating markets.
7. **Short-Term Focus:** CVP is typically useful for short-term decisions and doesn't consider long-term strategic factors like investments and growth.

These limitations make CVP more applicable for internal, short-term decision-making but less reliable for complex, long-term planning.

c) ABC company's projected information is as follows : -10

	Amount in Taka	
	Total	Per Unit
Sales	2,00,000	20
Variable cost	1,20,000	12
Fixed cost	64,000	—

You are requested to :

- (i) Compute the Break-Even point in units.
- (ii) How many units must be sold to earn a profit of Taka 30,000?
- (iii) Compute the Contribution Margin and Contribution Margin Ratio.
- (iv) Compute the additional profit that ABC would earn if the sales were Taka 25,000 more.

Q6.

a) Describe the different ways to financing a project. -6

There are several ways to finance a project, each with its own advantages and considerations. Here are the main methods:

1. **Equity Financing:** This involves raising capital by selling shares of the company or ownership interest in the project. Investors, such as venture capitalists or angel investors, provide funds in exchange for equity or a stake in the business. The advantage is that the company does not have to repay the funds, but it gives up a portion of ownership and control.
2. **Debt Financing:** This method involves borrowing money, usually in the form of loans or bonds, to fund the project. The project owner or company agrees to repay the borrowed amount with interest over a set period. The advantage is that the ownership remains unchanged, but the downside is the obligation to repay the loan with interest, regardless of the project's success.
3. **Grants and Subsidies:** Governments, non-profit organizations, or international agencies may provide grants or subsidies for specific projects, particularly those that serve social, environmental, or scientific purposes. These funds typically do not require repayment, but the project must meet specific criteria.
4. **Crowdfunding:** Crowdfunding involves raising small amounts of money from a large number of people, typically through online platforms. This method is common for smaller projects or start-ups and can be in the form of donations, rewards, or equity stakes.
5. **Joint Ventures:** In this approach, two or more entities collaborate and share resources, expertise, and capital to fund and manage a project. This reduces the financial burden on each party and spreads risk.
6. **Leasing or Asset Financing:** This involves financing through leasing equipment or other assets needed for the project rather than purchasing them outright. This can reduce initial capital requirements and provide flexibility.
7. **Internal Financing (Retained Earnings):** Companies may use their own profits or reserves to finance a project, without seeking external funding. This method avoids debt or equity dilution, but it may limit funds for other projects.
8. **Project Finance:** This method involves raising capital based on the future cash flows that the project is expected to generate. It is often used for large-scale infrastructure or energy projects, where repayment is linked to the project's revenue generation.

Each financing method has its pros and cons, and the best option depends on the project's size, risk, and the company's financial health.

b) What is the role of credit management in Banks? -8

Credit management plays a crucial role in banks by ensuring that lending activities are carried out effectively and efficiently, minimizing risks while maintaining profitability. The primary responsibilities and roles of credit management in banks include:

1. **Risk Assessment:** Credit management involves evaluating the creditworthiness of potential borrowers through thorough assessments of their financial position, credit history, and repayment capacity. This helps the bank mitigate the risk of loan defaults.
2. **Loan Approval Process:** Credit management is responsible for setting the criteria for loan approvals and ensuring that the bank follows sound practices in granting credit. It ensures that loans are granted to individuals or businesses that can repay them within agreed terms.
3. **Credit Policy Implementation:** Banks establish credit policies that define the terms, limits, and guidelines for lending. Credit management ensures that these policies are consistently followed, adapting to changes in market conditions or regulatory requirements.
4. **Monitoring and Follow-up:** Once loans are issued, credit management involves tracking the repayment process, ensuring timely payments, and addressing any issues related to missed or late payments. This includes regular review of borrowers' financial health.
5. **Debt Recovery:** In case of defaults, credit management is responsible for implementing strategies to recover the outstanding debt. This can involve restructuring loan terms, negotiating with borrowers, or initiating legal actions.
6. **Credit Risk Control:** Credit management also involves managing the bank's overall credit portfolio, ensuring diversification to prevent overexposure to any single borrower or sector. It also monitors and mitigates risks related to changes in interest rates, economic conditions, and borrower behavior.
7. **Ensuring Compliance:** Credit management ensures that all lending activities comply with regulatory requirements and internal bank policies. This helps in reducing legal risks and penalties associated with non-compliance.
8. **Customer Relationship Management:** While managing credit, banks also aim to maintain positive relationships with borrowers, offering solutions and assistance in case of financial difficulties, which can help retain customers and ensure repayment.

In summary, effective credit management helps banks manage credit risk, maintain financial stability, and ensure the sustainable growth of the lending portfolio.

### c) What are the impacts of provision shortfall on Bank's financial health? -6

A provision shortfall occurs when a bank fails to set aside sufficient reserves to cover potential loan losses, impacting its financial health in several ways:



1. **Increased Risk of Insolvency:** If the provisions for bad debts are inadequate, the bank may not have enough capital to absorb losses from defaulted loans. This could lead to a liquidity crisis and, in severe cases, insolvency.
2. **Decreased Profitability:** A shortfall in provisions may result in higher-than-expected loan defaults, leading to increased write-offs. This directly affects the bank's profitability, as losses reduce income.
3. **Regulatory Penalties:** Banks are required by regulators to maintain adequate provisions. A shortfall could lead to non-compliance, triggering penalties or restrictions on operations, and damaging the bank's reputation with regulators and investors.
4. **Capital Adequacy Issues:** Insufficient provisions can affect a bank's capital adequacy ratio (CAR), a key measure of financial stability. A low CAR can restrict the bank's ability to raise new funds and might lead to higher borrowing costs.
5. **Investor Confidence:** A provision shortfall can signal poor risk management practices, eroding investor confidence and negatively impacting the bank's stock price or market reputation.

In summary, a provision shortfall undermines the bank's financial stability, profitability, and regulatory standing, jeopardizing its long-term health.

Q7.

a) What are the purposes of credit investigation? -6

The purposes of credit investigation are essential for assessing the creditworthiness of individuals or businesses seeking loans or credit. The key purposes include:

1. **Assessing Creditworthiness:** Credit investigation helps determine whether a borrower can repay a loan based on their financial history, current financial position, and credit behavior. It provides insight into the risk involved in lending to that borrower.
2. **Minimizing Credit Risk:** By evaluating a borrower's past repayment habits, outstanding debts, and financial stability, credit investigations help banks and lenders identify high-risk borrowers. This reduces the likelihood of defaults or bad debts.
3. **Setting Loan Terms:** The information gathered during a credit investigation helps lenders set appropriate loan terms, such as interest rates, repayment schedules, and loan amounts, based on the borrower's credit profile.
4. **Fraud Prevention:** Credit investigations help identify fraudulent activities by verifying the authenticity of the borrower's information. This ensures that the borrower is legitimate and not attempting to deceive the lender.
5. **Protecting Bank's Financial Health:** Proper credit investigation safeguards the bank or lender's financial health by preventing the approval of loans that may result in significant losses or defaults.
6. **Regulatory Compliance:** Banks and financial institutions are required to perform due diligence and follow regulatory standards when lending. Credit investigations ensure compliance with these regulations.

In summary, the purpose of credit investigation is to protect lenders, reduce risk, and ensure that credit is granted to reliable and responsible borrowers.

b) Distinguish between registered Mortgage and Equitable Mortgage. -7

**Registered Mortgage** and **Equitable Mortgage** are two types of mortgages that differ primarily in terms of legal formalities and registration requirements. Here are the key differences:

1. **Legal Formalities:**
  - **Registered Mortgage:** A registered mortgage involves the formal registration of the mortgage deed with the appropriate legal authorities, typically the land registry or a similar government office. The process includes the creation of a legal document that is officially recorded.
  - **Equitable Mortgage:** An equitable mortgage, on the other hand, does not require formal registration. It is typically created by a simple deposit of the title deeds of the property with the lender, along with an agreement to repay the loan.
2. **Ownership and Title:**

- **Registered Mortgage:** In a registered mortgage, the legal title to the property is transferred to the lender (mortgagee) until the loan is repaid in full.
  - **Equitable Mortgage:** The borrower retains the ownership and title of the property, but the lender has an equitable interest in the property, meaning the lender has a right to the property if the borrower defaults on repayment.
3. **Legal Status:**
- **Registered Mortgage:** It is a legal mortgage, and the lender's rights over the property are enforceable in a court of law.
  - **Equitable Mortgage:** It is an equitable mortgage, meaning it is based on fairness and the agreement between the parties, but it is not as formally enforceable as a registered mortgage.
4. **Registration Requirement:**
- **Registered Mortgage:** It requires the mortgage to be registered with the relevant government authority, making it a public record.
  - **Equitable Mortgage:** There is no requirement for registration, and it is often used when the borrower does not wish to undergo formal registration procedures.
5. **Priority:**
- **Registered Mortgage:** Registered mortgages usually have priority over equitable mortgages in case of default and bankruptcy, as they are officially recorded in the land registry.
  - **Equitable Mortgage:** Equitable mortgages have lower priority than registered mortgages and may be subject to the rights of other creditors or claims on the property.

In summary, **registered mortgages** are formally documented and registered, granting the lender full legal rights over the property, whereas **equitable mortgages** involve less formal agreements and rely on the principles of equity, with the borrower retaining ownership but granting the lender an interest in the property.

### c) What are the advantages of Syndicated Financing? -7

Syndicated financing offers several advantages for borrowers and lenders alike:

1. **Risk Diversification:** By involving multiple lenders, the risk associated with a large loan is spread among all participants. This reduces the exposure each individual lender faces if the borrower defaults.
2. **Access to Larger Sums:** Syndication enables borrowers to access significantly larger amounts of capital than a single lender might be willing or able to provide, facilitating large-scale projects or expansions.
3. **Expertise and Relationship Building:** A syndicate can bring together lenders with different areas of expertise, improving the assessment and management of complex financing. This can lead to more favorable terms and improved project oversight.

4. **Efficient Capital Allocation:** For lenders, participating in a syndicate allows them to engage in sizable transactions without overstretching their balance sheets. It also provides opportunities to diversify their lending portfolios.
5. **Market Credibility:** Borrowers benefit from the collective credibility of a syndicate of reputable financial institutions. This can enhance investor confidence and potentially lower borrowing costs.

Overall, syndicated financing is a strategic tool that facilitates access to large amounts of capital while balancing risks and leveraging diverse financial expertise.

Q8.

a) What are the elements of a good lease document?-7

A good lease document clearly outlines the rights and responsibilities of both the lessor and the lessee, ensuring there is no ambiguity. Key elements include:

- **Identification of Parties:** Names and contact information for both the landlord and tenant.
- **Property Description:** A detailed description of the leased premises, including address and any included facilities.
- **Lease Term:** Start and end dates, with provisions for renewal or termination.
- **Rent and Payment Terms:** Amount of rent, due dates, acceptable payment methods, and provisions for late fees or rent adjustments.
- **Security Deposit:** Amount required, conditions for its return, and deductions in case of damage.
- **Maintenance and Repairs:** Clear allocation of responsibilities for repairs, maintenance, and upkeep of the property.
- **Permitted Use:** Specific uses allowed on the premises, along with any restrictions.
- **Insurance and Liability:** Requirements for property insurance, liability coverage, and indemnification provisions.
- **Default and Remedies:** Conditions that constitute a breach of contract and the steps that follow, including eviction procedures.
- **Dispute Resolution:** Mechanisms such as mediation or arbitration to resolve conflicts.
- **Amendment and Termination Clauses:** Procedures for modifying the lease and conditions under which the lease can be terminated.

These elements help create a robust lease agreement that protects both parties and minimizes potential disputes.

b) What is difference between pledge and Hypothecation?-6

Here are several variations outlining the differences between pledge and hypothecation:

- **Definition:**
  - **Pledge:** Involves transferring possession of an asset to the lender as security for a loan.
  - **Hypothecation:** The borrower retains possession of the asset while using it as collateral for the loan.
- **Possession:**
  - **Pledge:** The creditor physically holds the pledged asset until the debt is repaid.
  - **Hypothecation:** The asset remains with the borrower, and only the lender's right to claim it in default is secured.
- **Control:**
  - **Pledge:** The lender has control over the asset during the loan period.
  - **Hypothecation:** The borrower maintains control and use of the asset.

- **Application:**
  - **Pledge:** Often used for movable assets like stocks, bonds, or physical goods.
  - **Hypothecation:** Common in cases of movable or immovable property, especially in scenarios like securing loans against inventory or receivables.

### c) What are the advantages of Hire-Purchase financing? -7

Hire-purchase financing is an attractive option for individuals and businesses looking to acquire assets without bearing the full cost upfront. This method allows borrowers to gradually pay for an asset while enjoying its use immediately. Here are the key advantages of hire-purchase financing:

- **Immediate Use of the Asset:** Borrowers can put the asset to use right away, enhancing productivity or meeting urgent needs.
- **Spread-Out Payments:** The cost is divided into manageable installments, easing the financial burden and improving cash flow.
- **Path to Ownership:** Once all payments are completed, the borrower owns the asset, offering long-term benefits and value.
- **Fixed Payment Terms:** Predictable, scheduled payments assist in effective budgeting and financial planning.
- **Lower Initial Outlay:** A smaller initial deposit makes it accessible to borrowers with limited funds, lowering the barrier to entry.
- **Potential Credit Building:** Consistent, on-time payments can help improve the borrower's credit history over time.

In conclusion, hire-purchase financing provides a practical means of asset acquisition by offering immediate access, manageable payments, and eventual ownership. Its structured approach not only helps maintain liquidity but also supports long-term financial stability and creditworthiness.

Q9.

a) What is working capital? -2

Working capital is the amount of funds a business has available to manage its day-to-day operations. It is calculated as the difference between current assets—such as cash, inventory, and accounts receivable—and current liabilities, which include short-term obligations like accounts payable and other accrued expenses.

This financial metric indicates a company's liquidity and its ability to cover short-term debts, invest in operational needs, and respond to unexpected expenses. Essentially, working capital is a measure of operational efficiency and short-term financial health, ensuring that the business can sustain its ongoing activities without financial strain.

b) What are the factors that affect the requirement of working capital?-3

Working capital requirements are influenced by various internal and external factors that determine how much liquidity a business needs to efficiently run its day-to-day operations. These factors help a company balance its current assets and current liabilities to maintain smooth operations and growth.

**Key Factors Affecting Working Capital Requirements:**

- **Nature of Business:** Businesses with long production cycles or high inventory needs typically require more working capital.
- **Operating Cycle:** The time between acquiring raw materials and receiving cash from sales affects working capital. Longer cycles necessitate higher capital.
- **Credit Policy:** The terms of credit extended to customers and received from suppliers can either increase or decrease working capital needs.
- **Sales Volume and Growth:** Rapidly growing businesses often require additional working capital to support increased production and inventory.
- **Seasonal Fluctuations:** Seasonal industries may experience peaks and troughs in working capital requirements based on demand variations.
- **Efficiency of Operations:** Effective inventory management and faster collection of receivables can reduce the working capital needed.
- **Economic Conditions:** External factors like inflation, interest rates, and market conditions can impact working capital by influencing costs and cash flow.

In conclusion, understanding these factors enables businesses to tailor their working capital strategies to ensure liquidity, sustain operations, and support growth while minimizing financial risk.

c) A Proforma Cost Sheet of XYZ Company provides the following data:

<b>Cost (Per unit) :</b>	<b>Taka</b>
Raw materials	52.00
Direct labor	19.50
Overheads	39.00
Total cost (per unit)	<u>110.50</u>
Profit	<u>19.50</u>
Selling price	130.00

The following is the additional information :

Average Raw Material in stock : One Month

Average Material in process : Half a Month

Credit allowed by suppliers : One Month

Credit allowed to debtors : Two Months

Time lag in payment of wages : One and a half weeks

Time lag in payment of overheads : One Month

One-fourth of sales are on cash basis.

Cash balance is expected to be Taka 1,20,000.

You are required to prepare a statement showing the Working Capital needed to finance a level of activity of 70,000 units of output. You may assume that production is carried on evenly throughout the year and wages and overheads accrue similarly.



#### **Q10. Write Short Notes (any five)**

- a) Lender of Last Resort
- b) Open market operation
- c) Default Loan
- d) Liquidity Ratio
- e) Off-shore Banking
- f) Margin of Safety
- g) Expected Loan Loss

##### **a) Lender of Last Resort**

The "Lender of Last Resort" (LOLR) refers to a role typically performed by a central bank to provide emergency financial assistance to banks or other financial institutions that are facing liquidity problems but are solvent in terms of assets. This function is critical during financial crises when banks are unable to meet withdrawal demands from customers, leading to potential bankruptcies or systemic failures. By providing short-term loans, the LOLR helps to prevent bank runs and maintains overall financial stability, reassuring the market that institutions will not collapse. The central bank, in this case, acts as the ultimate backstop to maintain confidence in the financial system.

For example, during the 2008 financial crisis, central banks worldwide (like the Federal Reserve and the European Central Bank) provided significant loans to struggling institutions to stabilize the economy.

##### **b) Open Market Operation**

Open market operations (OMO) are the buying and selling of government securities (such as bonds) by a central bank in the open market. This is one of the most common tools used by central banks to regulate the money supply and control short-term interest rates.

- **Buying securities** increases the money supply by injecting liquidity into the financial system, usually to stimulate economic activity.
- **Selling securities** reduces the money supply by pulling liquidity out of the financial system, which is typically done to combat inflation.

By adjusting the money supply, central banks use OMOs to influence short-term interest rates, banking reserves, and overall economic conditions. For instance, when the Federal Reserve buys bonds, it increases reserves in banks, encouraging them to lend more and lower interest rates.

##### **c) Default Loan**

A loan is considered in default when the borrower fails to make the required payments as per the

loan agreement, whether that be interest or principal, within the agreed-upon timeframe. Defaulting on a loan can occur for a variety of reasons, such as the borrower facing financial hardship or simply not prioritizing repayment.

A default loan can have serious consequences for the borrower, including:

- **Legal actions:** The lender may sue for repayment.
- **Credit score damage:** Defaults negatively affect the borrower's creditworthiness, making future borrowing more difficult and expensive.
- **Repossession of collateral:** In secured loans, the lender may seize the collateral (e.g., a house or vehicle).

Lenders generally set a grace period before officially declaring a loan default, which can vary based on the terms of the loan agreement.

#### **d) Liquidity Ratio**

Liquidity ratios are financial metrics used to measure a company's ability to meet its short-term obligations using its most liquid assets. These ratios are essential for evaluating the financial health and operational efficiency of a business, especially its ability to handle unexpected financial pressures.

Key liquidity ratios include:

- **Current Ratio:** Calculated as current assets divided by current liabilities. A ratio above 1 indicates the company can cover its short-term liabilities with its short-term assets.
- **Quick Ratio (Acid-Test Ratio):** A stricter measure, calculated as (current assets - inventory) divided by current liabilities. This ratio excludes inventory because inventory might not be easily liquidated.

A higher liquidity ratio means that a company is better positioned to meet short-term obligations, while a lower ratio indicates potential liquidity problems.

#### **e) Off-shore Banking**

Off-shore banking involves holding bank accounts in a foreign country, typically in jurisdictions that offer favorable banking regulations, such as low or no taxes, privacy, and stable political conditions. Offshore banks are located outside the depositor's home country, often in financial hubs like Switzerland, the Cayman Islands, or Luxembourg.

Benefits of off-shore banking include:

- **Tax Advantages:** Certain jurisdictions offer lower tax rates or tax-free banking services.
- **Confidentiality:** Off-shore banks are known for their discretion and offer increased privacy for account holders.

- **Diversification:** It provides an opportunity to diversify assets internationally, reducing exposure to any single country's economic or political risks.

However, off-shore banking is often associated with regulatory concerns, and there are increasing efforts globally to improve transparency and combat money laundering and tax evasion.

#### **f) Margin of Safety**

The margin of safety is a risk management concept used by investors, particularly in value investing. It refers to the difference between the intrinsic value of a business or asset and its market price. A larger margin of safety implies that the investor has a cushion in case the market price falls, providing protection against poor judgment or unforeseen economic changes.

For instance, if an investor estimates that the intrinsic value of a company's stock is \$100 per share but it is currently trading at \$70, the margin of safety would be \$30. This cushion helps mitigate risks, as the stock has room to fall in value before the investor faces a loss.

The margin of safety is critical in minimizing downside risk, especially in uncertain or volatile markets.

#### **g) Expected Loan Loss**

Expected loan loss is a financial metric used by banks and financial institutions to estimate the potential losses from loans that may default over a specified period. It's typically calculated using historical data, the creditworthiness of borrowers, and economic conditions. The concept helps institutions set aside provisions for bad debts to ensure their financial health.

Expected loan loss is calculated by analyzing:

- **Probability of Default (PD):** The likelihood that a borrower will default on the loan.
- **Loss Given Default (LGD):** The potential loss the lender would incur if the borrower defaults.
- **Exposure at Default (EAD):** The total value of the loan at the time of default.

Financial institutions use these calculations to set up **loan loss provisions**, which act as a financial buffer against anticipated defaults. Properly estimating expected loan losses is crucial for managing financial risks and maintaining regulatory compliance.

