# CHAPTER 5: CREDIT COLLATERALIZATION

## 5.1 Introduction of the Unit of Learning/Unit of Competency

Credit collateralization is a unit of competency offered in TVET Level 6 banking and finance course qualification. This unit specifies the competencies required to establish credit collateral. It involves identifying security options, determining sufficiency of collateral, signing and witnessing the legal documents, conducting joint registration and maintaining credit security documents. The significance of credit colorization to TVET level 6 banking and finance curriculum is to equip learners with knowledge and skills to demonstrate communication, reporting, complaint handling, leadership skills, team player, organizing, time management, problem solving, analytical, computer packages, bank operational procedures, legal operating environment, banking policies and procedures and security management so as to fit well in the world of work.

The critical aspects of competency to be covered include demonstrated ability to match exposure with collateral, determine sufficiency of the collateral, sign and witness the legal documents, conduct joint registration and maintain credit security documents. The basic resources required include computers, phones, stationery, furniture, list of approved lawyers and transport.

The unit of competency covers 5 learning outcomes, each of the learning outcome presents; learning activities that covers performance criteria statements creating trainees an opportunity to demonstrate competecies stipulated in the occupational standards and content in curriculum. Information sheet provides; definition of key terms, content and illustration to guide in training. The competency may be assessed through written test, demonstration, practical assignment, interview/oral questioning and case study. Self-assessment is provided at the end of each learning outcome. Holistic assessment with other units relevant to the industry, sector, workplace and job role is recommended.

## 5.2 Performance Standard

Security options, legal documents and credit security documents as per credit policy and credit category.

## 5.3 Learning Outcomes

### 5.3.1 List of Learning Outcomes

a) Identify security options
b) Determine sufficiency of collateral
c) Execute legal document
d) Conduct security perfection
e) Maintain credit security documents

### 5.3.2 Learning Outcome No 1: Identify Security Options

#### 5.3.2.1 Learning Activities

| Learning Outcome No 1: Identify security options | |
|---|---|
| **Learning Activities** | **Special Instructions** |
| 1.1 Determine the type of collateral as per credit category<br>1.2 Determine the exposure as per the credit policy<br>1.3 Match the exposure with collateral as per the credit policy | Written assessment<br><br>Demonstration<br><br>Practical |

#### 5.3.2.2 Information Sheet No5/LO1: Identify Security Options

**Introduction**

This learning outcome covers; security documents, types of security documents, Importance of the security documents, collateral, types of collateral, importance of collateral and collateral for different types of credits.



**Definition of key terms**

**Collateral:** A collateral is a property or an asset that an individual (borrower) provides to a lender to act as a security for a loan.

**Credit:** In the financial sector, the term credit has various meanings. However, it can generally be defined as: a contractual agreement where a person who is borrowing gets a valuable thing now and promises to repay at a later date with an additional amount normally referred to as interest.

**Content/Procedures/Methods/Illustrations**

**1.1 Type of collateral is determined as per credit category**

When getting a loan or credit from a bank or financial institutions, the lender the lender has to look to the collateral depending on the credit category. The credit categories are classified according to the credit policies of a lending institution. There are various types of categories of collateral that lending institutions considers before extending credit to a borrower. Collaterals can be classified into the following categories;

- **Intangible collateral**

This is a collateral that is not physical and in many cases, it is difficult to attach a financial value to such a collateral. Examples of intangible collateral include; patents, trademarks, goodwill and copyrights among others. In most cases, financing or lending institutions do not accept intangible collaterals as a security for a loan or credit.

- **Tangible collateral**

Tangible collaterals are physical properties that an individual or organization can use to secure a loan. Examples of tangible collaterals loan includes: Vehicles, land, equipment, machinery and stock among others.

**Categories of credit**

Credit or loans are divided into two main classes;

a) **Open ended credit:** This is a form of credit where an individual uses a credit card to make purchases but repays the whole amount used at the end of the month.
b) **Closed-ended credit:** In closed ended credits, the borrower repays a specific amount of the sum in installments on a periodical basis.

**Collateral for different types of credit**

- **Secured personal loans:** For an individual to get a secured loan, he or she will use as collateral such as a car or certificate of deposit as a security for the loan.
- **Title loans:** When an individual has a property such as a car or land, car title or land title deed can be used as collateral.
- **Home equity loans:** In the home equity credit, an individual's home is used as collateral. An individual can only borrow up to 85% of the equity amount that he or she has in the home.



**Importance of collaterals**

- Collateral helps the lender to take the property and sell it for repayment, if the borrower defaults to repay the loan.
- It enables the borrower to have a high chance of getting the loan.

**Credit security documents**

These are documents that are used in ascertaining the information provided in the credit agreement. It can include: guarantee of the credit, the pledge agreement and other agreements as pertaining to the security of securing credit

**Types of security documents**

- **Personal security document:** This is a document that shows the personal details and security information of the person who wants to access a loan.
- **Title deeds:** This is a security document that stands in place of land owned by a borrower.
- **Car logbook:** A car logbook is a document that stands in place of a car that is used as collateral for a loan.

### 1.2 Exposure is determined as per the credit policy

Credit exposure refers to the amount of money that will be lost when a borrower fails to repay the loan. When giving loans, banks prefer increasing their loan exposure to individuals who have high credit ratings.

**Determining credit exposure**

In determining credit exposure, financial institutions assess the credit rating of a borrower. An individual with a high credit rating has a high credit exposure as compared to an individual with a low credit rating.

**Controlling credit exposure**

Based on the policy of a lending institution, there are various methods used in controlling loan credit exposure. Some of these methods include;

- **Creating credit limits:** A lending institution assesses the ability of a borrower to repay the amount borrowed. After assessing, it places a certain limit that the credit card user cannot exceed.
- **Offering different credit limits to borrower:** Difference between credit exposure and credit risk. Although the two terms are often used interchangeably, credit exposure is actually one of the components of credit risk. Credit exposure helps in measuring the magnitude if a loss occurs. Credit risk on the other hand, is the likelihood of a loss occurring or the probability of a borrower to default in repaying the loan.



### 1.3 Exposure is matched with collateral as per the credit policy

Matching risk exposure with collateral refers to the process of assessing the amount of money that will be lost, when the borrower defaults to repay the amount borrowed against the collateral that the borrower has provided.

**Factors to consider when matching collateral with credit**

- **Credit rating of the borrower:** Financing institutions compare credit exposure with the credit rating before identifying the type of collateral to demand. A borrower with a high credit rating will require a lesser collateral or lower value collateral as compared to a borrower with a low credit rating.
- **Risk of the loan:** Lending institutions compare the risk of the loan before lending or offering the loan in comparison of the collateral they demand. The riskier loan will attract high valued collateral whereas a less risky loan will attract less valued collateral.
- **Risk level of the lending institutions:** Lending institutions that are risk averse prefer to have more or highly valued collateral so that they can recover their credit easily in case the borrower defaults. On the other hand, lending institutions that are risk takers may not pay much attention to the value of collateral.

Therefore, they offer credit even though the credit amount does not match the type of collateral provided. However, such institutions have established various strategies that reduce the risk of losing the amount loaned.

**Conclusion**

This learning outcome covered; security documents, types of security documents, importance of the security documents, collateral, types of collateral, importance of collateral, and collateral for different types of credits.

**Further Reading**

1. Read on the current changes that lending institutions have put in place in assessing securities for loans.

**5.3.2.3 Self-Assessment**



**Written Assessment**

1. Which of the following is an example of tangible collaterals?
   a) Patents
   b) Vehicles
   c) Land
   d) Machines
2. Which of the following does not form part of tangible collaterals?
   a) Land
   b) Goodwill
   c) Computers
   d) Vehicles
3. The following are classes of collaterals. Which one is odd one out?
   a) Tangible collateral
   b) Closed ended credit
   c) Intangible collateral
   d) Invoice collateral
4. Which one of the following forms part of the security document?
   a) Notebook
   b) Newsletter
   c) Title deed
   d) Invoice

5. Which of the following is correct about categories of credit?
    a) Everyone can access all credit categories.
    b) All credit categories have similar credit facilities.
    c) All financial institutions offer similar loan categories.
    d) Some loan categories are open ended while others are closed ended.
6. The following are true about the importance of collaterals. Which one is false?
    a) They cover for the loan borrowed.
    b) In case a borrower defaults collateral can be sold to recover the loan.
    c) They help the borrower have easy access to loan facilities.
    d) They facilitate easy assessment of a loan.
7. Which one of the following terms fails to fit in the study of security options and credit?
    a) Collateral
    b) Security document
    c) Risk exposure
    d) Customer experience
8. Interpret the term collateral.
9. Differentiate between credit risk and credit exposure.
10. Analyse factors to be considered when matching exposure and collateral.
11. Evaluate the term credit.
12. Categorise methods used in controlling credit exposure.]



**Oral Assessment**

1. What is the difference between open ended credit and closed ended credit?
2. What is a security document?

**Case Study Assessment**

Tala is one of the companies that provide credit to most young people in Kenya. It is evident that the company does not require collateral for it to extend credit/ loans to the borrower who uses the application. It therefore means that the company is a risk taker and does not match its credit exposure to the collateral. However, the company uses strategies such as quick increment of loan amount to encourage borrowers to continue borrowing and refund the money borrowed. Nevertheless, the company has suffered many credit risks due to high rates of defaulting clients.

a) From the case study, assess if it is important to match collateral with credit exposure.

**5.3.2.4 Tools, Equipment, Supplies and Materials**

- Writing materials
- Projector
- Computer
- Flip Chart/white board
- Computers

- Phones
- Stationery
- Furniture
- List of approved lawyers
- Transport

#### 5.3.2.5 References


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Hamza's' (2017) impact of credit risk management on banks performance: A case study in Pakistan Banks, European Journal of Business Management; 9 (1) 57-64

Lakdawala .A. Minett, R., &Olivero. (2017). Intermarket and credit policies amid sovereign debt crisis (No 2017-1) Lebow College of Business. Drexel University.

### 5.3.3 Learning Outcome No 2: Determine Sufficiency of Collateral

### 5.3.3.3 Learning Activities

| Learning Outcome No 2: Determine Sufficiency of Collateral | |
|---|---|
| **Learning Activities** | **Special Instructions** |
| 2.1 Determine security ownership as per law<br>2.2 Determine security caveat as per law<br>2.3 Determine the use of collateral elsewhere as per law<br>2.4 Conduct security valuation as per credit policy | Case studies<br>Direct instruction<br>Written Assessment |

### 5.3.3.2 Information Sheet No5/LO2: Determine Sufficiency of Collateral

**Introduction**

This learning outcome covers; collaterals, methods of collateral valuation and how banks determine the value and sufficiency of collaterals and its importance.

**Definition of key terms**

**Collateral:** This is an asset that a loan borrower pledges to extend to acknowledge that they must finish their loan repayment.



**Security ownership:** This is the legal possession or control of an asset.

**Security valuation:** This is the process by which banks have to investigate the amount by which the security of borrower is worth.

**Security caveat:** This is an order by the court requiring a debtor not to sell the property without the banks consent.

**Content/Procedures/Methods/Illustrations**

**2.1 Security ownership is determined as per law**

Law is a system of rules that defines how people of a particular community or country should conduct themselves. Law is enforceable. Security ownership is being in possession of an asset. The ownership of security or securities of borrowers has to be legal i.e. the possession of assets of borrowers has to be formal and standardized according to the law.

**Establishment of legal ownership of collateral**

Collateral can be any asset e.g. shares or stock, land, building, vehicles etc. The borrower/debtor has to produce or prove that he/ she owns the security that is to be used as collateral. E.g. for land, a borrower can produce a title deed that is valid, for vehicle a person can produce receipt, driving license, etc. The borrower normally has the full authorization to pledge, transfer, and sell the security. Having the documents such as title deed establishes that the borrower legally owns the asset.

**2.2 Security caveat is determined as per law**

A security caveat is normally lodged to the court of law by the bank if the bank feels that the borrower might transfer or sell ownership of the collateral. The bank lodges a security caveat in reference to the law. A security caveat is normally an injunction i.e. requires one to stop doing something Security caveat is normally determined by the court of law if the banks do not have the power to prevent the debtor or borrower from transferring property, they can therefore file a security caveat. If the bank does not have a reasonable cause to lodge a caveat. The bank will be liable for any damages the debtor will incur. In cases of security caveat, the bank does not have the right to have the full ownership of the property or sell property.

**2.3 Use of collateral elsewhere is determined as per law**

Collateral can be used by the borrower or the bank (lender) in certain circumstance in reference to the law. Most banks as per law do not accept a debtor to use the same asset as collateral in acquiring loans in different banks or to transfer ownership of the asset used as collateral. There are different ways a debtor can use collateral elsewhere:

- Transfer ownership of the asset by selling it.
- Use the same collateral as collateral in acquiring other banks.
- The borrower can use the collateral if it is a non-current asset e.g. in cases where a business uses its stock as collateral, the business owner can still conduct its trading activities by using its stock.



**2.4 Security valuation is conducted as per credit policy**

Credit policy is a set of rules that govern how giving of credit to borrowers can be conducted. Credit policy can include: credit worthiness of borrowers, procedure of giving credit to borrowers and terms and conditions of giving credit, etc. The value of a security is worth a security. The value of a security is determined by the bank using the fair market value as per the relevant credit policy.

**Interpretation of valuation report**

Valuation report is interpreted by determining the very recent fair prices in the market for that particular asset to be used as collateral. The valuation report is normally prepared by a qualified experienced expert.

**Collateral valuation methods**

Collateral valuation methods used are as per the agreed accounting policies in a particular country or bank.

The principles applied though, should be widely accepted to reduce of variances that might occur. They include:

- **Cost approach:** The appraiser determines the value of the asset by taking into account the cost of reproducing it.
- **Market approach:** An appraiser determines the value of the asset by calculating the worth of similar asset that is the market price.
- **Income approach:** Investors normally pay for the expected income they will acquire each year from the asset and when the asset is finally sold by transferring ownership in the future.

**Discounting of collateral values**

Collateral values are discounted by incorporating the risks associated to asset being used as collateral. Discounted cash flow analysis is used e.g. Net present value analysis, internal rate of return.

**Importance of discounting collaterals**

- It takes into account time value of money i.e. the value of the collateral as at the present day from the time it was purchased.
- It is a good measure of profitability that can be gained from the collateral if the borrower defaults in paying the loan.
- It incorporates risks associated with the collateral so as to know the exact value of the collateral.



**Importance of establishing sufficiency of collateral**

For an asset to be used as collateral, the value of the collateral has to be sufficient enough and must be comparable to the amount of loan requested. Its importance is to assure the bank that it will get its money back if the borrower defaults in repaying the loan.

**Conclusion**

This learning outcome covered; collaterals, methods of collateral valuation and how banks determine the value and sufficiency of collaterals and its importance.

**Further Reading**

1. Read more on Collateral pricing by E Benmelech, NK Bergman- Journal of financial economics,2009- Elsevier
2. Read on Group lending, repayment incentives and social collateral by T Besley, S Coate- Journal of development economics, 1995- Elsevier

### 5.3.3.3 Self-Assessment

**Written Assessment**

1. Which of the following are two types of discounting collateral values?
    a) Net present value and cost approach
    b) Internal rate of return and net present value
    c) Cost of approach and net present value
    d) Market approach and cost approach
2. Which is an advantage of discounting collateral values?
    a) To know the profit to be made from collateral
    b) To sell the collateral
    c) To buy the collateral
    d) To dispose the collateral
3. Among the following you have learnt from this learning outcome except?
    a) How to buy shares
    b) Legal ownership of collateral
    c) Discounting of collateral values
    d) Valuation of collateral
4. Security caveat is given by___________.
    a) Court order
    b) Borrower
    c) Citizens
    d) Government
5. A valuation report is prepared by___________.
    a) Manager
    b) Appraiser
    c) Banker
    d) Teller
6. The person who goes to borrow a loan from a bank is called_____________.
    a) Borrower
    b) Citizen
    c) Father
    d) Creditor
7. Elaborate what a security caveat is.
8. Clarify what collateral is.
9. Identify three methods of collateral valuation.
10. Outline two types of discounting methods in collateral valuation.
11. Classify methods of marketing approaches.

**Oral Assessment**

1. Who issues a security caveat?
2. What is security valuation?

**Practical Assessment**

In a group of five students, visit the nearest bank and inquire the procedures that are followed by the bank to determine the value of assets used as collateral.

### 5.3.3.4 Tools, Equipment, Supplies and Materials

- A collateral valuation report
- Writing materials
- Projector
- Computer
- Flip chart/white board
- Computers
- Phones
- Stationery
- Furniture
- List of approved lawyers
- Transport



### 5.3.3.5 References


AA Rampini, S Viswanathan,. (2013). Collateral and capital structure Journal of financial Economics.

E Benmelech, NK Bergman- Journal of financial economics, (2009). Elsevier

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### 5.3.4 Learning Outcome No 3: Execute legal document

#### 5.3.4.1 Learning Activities

| Learning Outcome No 3: Execute legal document | |
|---|---|
| **Learning Activities** | **Special Instructions** |
| 3.1 Issue the customer with offer letter and other legal documents as per credit policy<br>3.2 Sign offer letter and other legal documents as per banking policy<br>3.3 Confirm offer letter and other legal documents as per credit policy<br>3.4 Sign offer letter and other legal documents by advocate as per credit policy<br>3.5 Witness *Legal documents* as per credit policy(Guarantee, 3rd party guarantee, Letter of hypothecation, Chattels mortgage, Directors guarantee) | Discussion forums<br><br>Lectures |

#### 5.3.4.2 Information Sheet No5/LO3 Execute legal document



**Introduction to learning outcome**

This learning outcome covers; legal documentation, types of legal documents, importance of securing the legal documents, parties involved in securing legal documentation maintenance of legal documents, archival and retrieval of legal documents.

**Definition of key terms**

**Legal documents:** These are documents that show some agreement between two people to at least one promise.

**Offer letter:** It is a letter given by a company to a potential employee that provides key terms of the expected employee's employment. Such key terms are title, full time work schedule and at will employment status.

**Credit policy:** It is a set of guidelines that are used to determine which customers are extended credit and unpaid invoice. It also it can be defied as limits to be set on the total amount you owe at a given time.

**Content/Procedures/Methods/Illustrations**

**3.1 Customer is issued with offer letter and other legal documents as per credit policy**

According to credit policy which is a government policy at a particular time on how easy or difficult it should be for individuals and businesses to borrow money and how much it will cost them. Credit policy requires the offer letter and other legal documents to be issued to customers for them to know their position on their credit request.

**Importance of signing legal documents**

- Security
- Signature binds the document
- Authorization
- Approval

**3.2 Offer letter and other legal documents are signed as per banking policy**

An offer letter is a letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. According to banking policy, offer letter and legal documents should be signed in order to make the contract bound and legal.



**Table 13. Sample of a bank offer letter**

| |
|---|
| Date---------------- |
| Business manager---------- |
| Name of a bank ----------------- |
| Branch address and location--------------------- |
| |
| Dear sir/madam---- |
| |
| Request for loan |
| In line with our company projected expansion, we plan to start mass production of ready-made dresses to supply bigger markets. Given our track record and experiences in the fashion industry and the marketability of our design we know we will make more profits and achieve our desired profits. For this purpose we are making a loan request (state amount) to facilitate the acquisition of more industry, weaving and embroidery machines, industrial sewing machines, the reconstruction and design of our present location, rebrand and promote the business on print and electronic media and on the internet. |
| We hope that our request will be given due attention. |
| |
| Dr. John Muchuvki |
| Managing director. |

**Types of legal documents**

- Bank statement
- Credit card receipt
- Paying slip
- Packing slip
- Lockbox check image
- Cash receipts
- Contracts

**What makes a signed document legal?**

- A signed document signifies knowledge and approval.
- If the document is legally enforceable as per the banking policy.
- If it is stated in the contract that it must be used.
- Signed documents acts as an acceptance of the contract in question.
- A signed documents acts as an obligation between the signor and the signee

## 3.3 Offer letter and other legal documents are confirmed as per credit policy

Confirm that all required documents have been received and the assessment process has begun. If your banks document requirements are met, steps taken to inform the applicant that the assessment process has begun and to provide information about the next steps for the applicant: Send an acknowledgement to indicate that. The following should be considered when offer letter and other legal documents are confirmed as per credit policy:

a) Focus on setting your credit limit: Documents should be confirmed if it has the credit limits before it is signed
b) Pay attention to your invoice structure may fail to pay; documents should have an invoice structure to make sure pay doesn't fall easily.
c) Establish a notifications system: They should have a notification system to show it can be used legally before being signed.
d) Require deposits: Document should have a request deposits before it is signed to make sure payments will be done.

## 3.4 Offer letter and other legal documents are signed by advocate as per credit policy

An advocacy is the process of standing beside an individual or group and speaking out on behalf to protect and promote their rights and interest.

**Types of advocacy**

- Self-advocacy
- Citizen advocacy
- Group advocacy
- Professional advocacy
- Non-instructed advocacy

**Principles of advocacy**

- **Clients directed:** They should act to the direction of the clients.
- **Confidential:** They must build trust between clients and advocate.
- **Duty of care:** They are a duty not to advocate in this that are illegal
- **Empowerment:** They must work to increase the power and control clients have over time.
- **Independent:** Meaning they must not have conflicts of interest
- **Needs based:** Service is provided to people in the clients group according to their needs. The services are free and equitable
- **Partisan:** Should always be on the disadvantaged side

**Benefits of signing offer letter and other legal documents**

- Protects your future self by signing the offer letter and other legal documents that are needed to legalize the contract. Signing them is acts as an approval in order to avoid arguments.
- The presence of a lawyer shows that the contract was legal and gives advices on how and when or what to consider and what condition should contract be signed
- An advocate helps the clients to make informed decisions
- An advocates signature makes the contract binding and fits for approval.
- Advocate stamps and signatures make the contract a legally enforceable.



**3.5 Legal documents are witnessed as per credit policy**

In a legal contract a witness is someone who either voluntarily or under compulsion, provides testimonial evidence, either orally or written of what he/she knows or claims to know.

**Essentials of a witness**

- Must be 18 years of age of majority in your state or province
- Have ability to make decisions
- Able to confirm the identity of the person who signing the document
- A neutral third party
- Must be of the right mind

**Types of witness**

- Eyewitness is someone who brings observation testimony to the proceedings after having seen an alleged contract.
- Expert witness: Is the one that has superior knowledge to the average person when it comes to the topic to testify about.
- Character this witness vouches under oath to the good reputation of another person often in the community where that person lives.
- Reliability of witness.

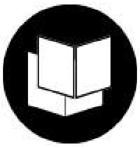
**The benefits of witnesses**

- Witnesses help to solidify and authenticate your contract by providing proof that the signatures are legitimate and consensual
- They're an important part of ensuring that your legal documents is legally sound when they are required
- Witnesses keeps you from having to face repercussions of having an invalid contract
- Helps to clarify what happened in the event

**Conclusion**

This learning outcome covered; legal documentation, types of legal documents, Importance of securing the legal documents, parties involved in securing legal documentation, signing of offer letter as per banking policy, confirming offer letters as per credit policy and legal document and knowing the legal documents.

**Further Reading**



1. Read on the consequences of signing offer letter and the role of witnesses.



**5.3.4.3 Self-Assessment**

**Written Assessment**

1. Which one of these is not a definition of key terms of learning outcome?
    a) Offer letter
    b) Legal documents
    c) Credit policy
    d) Debit policy
2. Which one of the following includes an offer letter?
    a) Start date and compensation
    b) Profit
    c) Credit
    d) Debit
3. Offer letters and other legal documents are signed as per banking policies. The following should be considered whether it can be negotiated or not except?
    a) Job responsibilities
    b) Base salary
    c) Bonuses
    d) Credit

4. What is the definition of credit policy?
    a) Is a letter given by a company to a potential employee
    b) Is a set of guidelines that are used to determine which customers are extended credit and billed
    c) Is a policy which specified from time to time
    d) Is a loam arrangement in which an item of movable personal properly acts as security for a loan
5. Which one of the following should be considered when offer letter and other legal documents are confirmed as per credit policy?
    a) Pay attention to your invoice structure
    b) Pay your debts
    c) Issue documents
    d) Offer loan
6. Which one of the following is not among the witnesses in legal documents as per policy?
    a) Guarantee
    b) Director guarantee
    c) $3^{rd}$ party guarantee
    d) Creditor
7. Choose the meaning of legal document in the following.
    a) Is a loan given to creditors
    b) Is a policy specified from time to time by the reserve book
    c) Document that shows some contractual relationship
    d) A letter give to a potential employee from a company
8. Propose the importance of having a witness.
9. Elaborate on credit policy.
10. Analyse two types of advocates.
11. Clarify the advantages of letter per credit policy.



**Oral Assessment**

1. What is the importance of having witness in offer letter?
2. What is the benefits of issuing offer letter and other legal documents as per credit policy?

**Case Study Assessment**

It was a usual evening at the office when we received a slightly visual inquiry. An attorney from the United States was considering the possibility of outsourcing his entire back office preparations to India. Even before we analysed his inquiry, we understood that this was not routine data entry work. We called up the client to discuss his enquiry in data.

#### 5.3.4.4 Tools, Equipment, Supplies and Materials

- Writing materials
- Projector
- Computer
- Flip chart/white board
- Computers
- Phones
- Stationery
- Furniture
- List of approved lawyers
- Transport

#### 5.3.4.5 References


Basu, SM. And Rolfer, H.A (1995), Strategic credit management John Wiley & son Inc. Toronto.

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### 5.3.5 Learning Outcome No 4: Conduct Security Perfection

#### 5.3.5.1 Learning Activities

| Learning Outcome, No 4: Conduct Security Perfection | |
|---|---|
| **Learning Activities** | **Special Instructions** |
| 4.1 Obtain security documents as per credit policy<br>4.2 Compile security documents as per joint registration legal requirement<br>4.3 Obtain legal charge on property as per banking policy | Case studies |

#### 5.3.5.2 Information Sheet No5/LO4: Conduct Security Perfection

**Introduction**

This learning outcome covers; how individuals come together to acquire a loan through joint registration, collateral, the different types of collateral that are used in joint registration and the types of legal charge imposed on the collateral assets.

**Definition of key terms**

**Legal joint registration:** This is the process by which two or more persons come together to register to own or have something

**Legal charge:** This is the process by which the bank protects the money they have lend to the borrowers by banks by having the right to take over the collateral of borrowers who do not pay their debts.

**Legal requirement:** This is an obligation that governments or state impose that have to be met by individuals or organizations.

**Credit Policy:** These are the set written principles on the basis of which the bank will determine who it will give loans to.

**Content/Procedures/Methods/Illustrations**

**4.1 Security documents are obtained as per credit policy**

Security documents are agreements that a borrower provides security interests in a specific asset to be used as collateral and it is done with reference to the relevant credit policies. Security interest is a process where the borrower gives the bank the legal right to reclaim part or all of the assets used as collateral if the borrower defaults to repay; loans i.e. stops paying the loans. The bank obtains the security documents in their possession. Joint registration is where there is a shared loan made to two or more persons i.e. borrowers.

All the borrowers in the joint registration are equally responsible for paying the loan to the bank. In joint registration there are assets used as collateral.

**Types of security documents**

- Indemnity agreement: This is an obligation that a borrower has to pay compensation to the bank if the borrower fails to pay their loan in full.
- Security Agreement: This is a document that shows a borrower owes the lender an unsecured loan, the lender wishes to secure the loan against the assets of the borrower.
- Debenture: This is a document that certifies and contains the terms and conditions of a debt, which is secured against all or considerably all the assets of the borrower.
- Chattel Mortgage: This is a mortgage that is created over a specified movable asset of a company as collateral for a loan.

**Importance of Joint Registration**

- There is more income pulled together as there are two or more persons who can help repay the loan.
- Joint registration makes it easy for the group to easily get a loan compared to when one is an individual. Because of more assets that are brought to the table to be used as collateral.
- Joint registration is better and the group easily gets loans if there are borrowers in the group who have high credit scores i.e. banks prefer to lend loans to borrowers who have a long credit history on borrowing and repaying loans on time.



**Reasons Borrowers should consider joint registration**

- The joint group since it combines personal incomes of different people gives them a better security level to the bank and the bank will be more comfortable in giving the loans.
- The joint group credit score can improve if there are borrowers in that group who have a really good credit score improving the overall credit rating of the joint group.

**Credit rating**

A credit score is a statistical number that determines the credit worthiness of a person. It is used by banks to determine:

- The persons who qualify for a loan
- The maximum amount of loan a borrower can be given
- At what interest rate will be borrower be given.

**4.2 Security documents are compiled as per joint registration legal requirement**

The security document entails one or more of the above-named assets is compiled and left to the bank. The assets are jointly owned by all the borrowers in the joint registration and they all equal interest in the assets used as collateral.

**Steps taken in registration of Different types of collateral;**

Once joint parties have written and signed security documents, they then register. In Kenya it is normally free. The registration is done online in the following process;

i. Open the website: www.ecitizen.co.ke in the internet
ii. If one does not have an account one can open an account by clicking create account. If one has an account one can login;
iii. Access Business registry services.
iv. Access the application form by clicking on collateral registry (MPPS).
v. Select the application from the list. Select the application from the list.
vi. Identify this application and click on the Blue highlighted application form of the top right corner.
vii. Open the application form and add the grantor details
viii. Add creditors details
ix. Enter collateral details
x. Enter secured loan particulars
xi. Review the application
xii. View the notice
xiii. Amend or cancel notice of registration



**Types of Collateral**

The following types of collateral can be used by joint registration.

- **Shares:** They can be taken away either by floating or fixed charge where shares have not been dematerialized, shares security can be taken over by depositing the relevant share certificates with the bank (Latham and Watkins 2016).
- **Land:** It can be sued by borrowers as charge or by depositing a title deed document to the bank.
- **Contractual rights:** This can be used as collateral by joint registration over contractual rights by way of a fixed or floating charge or an assignment in each case provided that here is nothing in the relevant contract that prohibits the granting of such security. (Langham and Watkins 2016)
- **Insurance proceeds:** This is a collateral over insurance proceeds can be used by joint registration groups and it can be taken away by banks by way of a charge over, or by way of an assignment of the relevant insurance contract (Latham and Watkins 2016)
- **Intellectual property:** This collateral bank will take e.g. trademarks. Copy rights and other intellectual property by sofa fixed or floating charge.

**Floating charge:** This charge is used by banks if borrowers use assets that change in value and quantity over time. E.g. Inventory: The borrowers can sell, buy inventory without asking for permission from the banks first. Other types of assets that can be used with floating charge are: vehicle, debtors etc.
**Fixed Charge**: This charge is created if borrowers have fixed assets e.g. Land, building, machinery etc. These assets are normally not sold by the borrowers. The bank (lender) has all control over the assets used as the borrowers are in possession over the assets.

**Table 14: Differences between floating and fixed charge**

| Basis of comparison | Fixed charge | Floating charge |
|---|---|---|
| Type of assets | Non-current assets | Current assets |
| Dealing in asset | Borrower have no right to deal with the assets | Borrowers can use the assets |
| Preference | Preferred first | Preferred secondly |
| What is it | A legal charge voluntary | Equitable charge |
| Registration of charge | Voluntary | Compulsory |

### Collateral Assignment

This relates to insurance policies where there is a conditional assignment of appointing the bank (lender) as the primary beneficiary of a death benefit to be used as a collateral for the loan.



### Parties involved in joint registration

- Company
- Partnerships
- Individuals
- Unincorporated associations
- Local authorities

### Costs involved in a joint registration

- When a joint loan is acquired, all parties in the joint registration sign a credit agreement that each of them will be responsible in paying the loan in full if the other party or parties fail to pay the loan. It never matters who spent the loan e.g. if two married couples have a joint loan and one spouse dies the other partner has to pay the loan in full.
- Interest is also incurred by borrowers in joint registration above the principle amount they borrowed from the bank.
- Time involved in repaying a loan should be considered as this can put pressure on borrowers of joint registration and this puts pressure on the borrowers.
- Penalties can be incurred in joint registration on credit acquired from the banks if the joint borrowers do not complete paying their loan on time.

- Being listed in the credit reference bureaus if the borrowers fail to repay their loan, they will be listed in CRB as defaulters and this can limit them in accessing more loans in the future. This is a cost to joint registration.

**4.3 Legal charge on property is obtained as per banking policy**

Legal charge is created by court of law on the terms of lenders having security interest over assets that are being secured and it is obtained in reference to the banking policy. A legal charge arises when the banks and borrowers agree with the bank to have a security interest in the collateral asset as a security for the loan. The borrowers must intend to give the bank a security interest in the collateral asset as a security for the loan. The borrowers must intend to give the bank a security interest which is identifiable to the collateral. The bank has no right to possess the asset used as collateral. When the borrowers fully repay the loan, the legal charge is terminated. A legal charge is usually against the borrowers if they fail to pay the loan. As discussed earlier, there can be three types of legal charge; fixed charge, floating charge and assignment charge. The legal charge must be informed of the contract where both parties i.e. the bank lenders and the borrowers have to sign.

**Conclusion**

This learning outcome covered: how individuals come together to acquire a loan through joint registration the borrowers use the assets they have as collateral, the different types of collateral that are used in joint registration and the different types of legal charge imposed on the collateral assets.



**Further Reading**

1. The learners can further read the following book; monitoring by delegates or by peers? Joint liability loans under moral hazard-J conning 2005.

**5.3.5.3 Self-Assessment**

**Written Assessment**

1. Which of the following is a type of a legal charge?
    a) Court charge
    b) Floating charge
    c) Homework charge
    d) None of the above

2. Which of the following is not party that can engage in joint registration?
    a) Individuals
    b) Companies
    c) Partnership
    d) None of the above
3. A joint registration is made up of?
    a) Two or more parties
    b) One company
    c) One unincorporated association
    d) One individual
4. Which of the following is not a cost associated with joint registration?
    a) Getting a loan more easily
    b) Being listed in CRB
    c) Limited repayment period
    d) Interest
5. Which of the following is a characteristic of a floating charge?
    a) It involves non-current asset
    b) The lender has full possession of the collateral
    c) Collateral used are current asset
    d) It is the most preferred charge
6. Which is an importance of joint registration?
    a) More ease to acquire a loan
    b) Less assets are brought on board to be used as collateral
    c) High costs are incurred in joint registration
    d) There can be low credit rating/score used as collateral
7. Which of the following is not an asset used as collateral?
    a) Shares
    b) Land
    c) Contractual rights
    d) None of the above
8. Elaborate on legal charge.
9. Outline two types of legal charge.
10. Elaborate who a borrower is.
11. Identify three costs involved in joint registration.
12. Outline four assets that can be used as collateral.



**Oral Assessment**

1. What is credit score?
2. Who is eligible in applying for joint registration?

**Practical Assessment**

With the help of your trainer, go to any Equity Bank branch and inquire of the procedure and requirements for joint registration.

**5.3.5.4 Tools, Equipment, Supplies and Materials.**

- Writing materials
- Projector
- Computer
- Flip chart/white board
- Computers
- Phones
- Stationery
- Furniture
- List of approved lawyers
- Transport
- A sample of a security document

**5.3.5.5 References**


Ameli inyangu and partners advocates (2017) Registration of Security Rights in Movable Property.

Hazard-J Conning (2005) M.onitoring by Delegates or by Peers? Joint liability loans under moral.

Latham and Watkins (2016) Taking security in Kenya – A comparative guide for investors.

MC Faulkner hand book of finance (2008). An introduction to securities lending.

### 5.3.6 Learning Outcome No 5: Maintain Credit Security Documents

#### 5.3.6.1 Learning Activities

| Learning Outcome No 5: Maintain Credit Security Documents | |
|---|---|
| **Learning Activities** | **Special Instructions** |
| 5.1 Fill legal documents as per standard operating procedures | Discussion forums |
| 5.2 Store security documents as per standard operating procedures | Lectures |
| 5.3 Maintain security documents register as per credit policy | Group discussions |
| 5.4 Maintain insurance register as the credit policy | |
| 5.5 Maintain valuation report as per credit policy | |

#### 5.3.6.2 Information Sheet No5/LO5: Maintain Credit Security Documents

**Introduction**

The learning outcome covers; maintenance of the credit security documents to completion. The procedures and methods given are standard thus fit across lending firms for the maintenance of such documents. The final practice of maintenance should be destruction of obsolete documents which creates space for new ones. That is the proper and efficient maintenance of such documents.



**Definition of key terms**

**Legal documents:** These are official written contractual agreements that show the relationship between two parties in this case being documents showing the rights of the debtor and the creditor.

**Insurance register:** This is a record of data for policy applications and claims which enables insurance companies to check, retrieve and confirm the accuracy of details

**Valuation report:** This is a written feedback which gives the detailed inspection and the asset market value as surveyed by the market body.

**Content/Procedures/Methods/Illustrations**

**5.1 Legal documents are filed as per standard operating procedures**

Filing legal documents requires proper maintenance and cataloguing to ensure that they can be easily accessed when need arises. Due to the material benefit that the documents have, their safety in filing should be made utmost through the choice of correct filing procedures and methods.

**Procedures of filing legal documents**

The standard operating procedure for filing legal documents for credit involves the following:

i. You receive the document directing you of the legal documents to be collected and field.
ii. Taking action to check whether the documents directed to be filed complete.
iii. Follow up whether the documents directed to be filed are the actual documents from the sender.
iv. Collect the documents directed to be field and organize them as required.
v. Confirm whether they are required documents and file them as required.
vi. Maintain the file system used to file the documents.
vii. Continually perform good housekeeping and safety of the room of the files to avoid any damage.

**Methods of filing legal documents**

i. **Filing by category:** Filing is done by grouping the legal documents that belong together and kept in a single file.
ii. **Filing by alphabetical order:** Filing of the legal documents as per the first alphabet appearing of the document.
iii. **Numerical order filing:** Documents to be filed are allocated numbers and filed in the order of those numbers.
iv. **Geographical order filing:** The legal documents are field according to the region they are from or the region of the owners.
v. **Filing by date:** The documents are filed according to the day of generation and authorization.



**Filing equipment**

- **Filing cabinet:** This is equipment for keeping flat and suspension files for an organization.
- **Steel cabinet:** Especially used to keep legal documents, the equipment is used safely to lock big files.
- **Date stamp:** It is for stamping documents to show the dates of receiving and authorization.
- **Filing register:** Refers to a record that shows the order of files in the shelves or in the box.
- **Filing shelves:** Suspended enclosures where files can be placed and locked.

**5.2 Security documents are stored as per standard operating procedures**

Credit security documents are very vital in the securing of the agreement between the creditor and the debtor. They safeguard the rights of the credit issuer to be assured of repayment of the finances lent out or benefiting from the terms spelt out in the agreement.

**Methods**

- **Softcopy formats:** With the massive use of technology in organizations today, the credit security documents can be converted to soft copy scanning and then be stored in computer systems within the client files. Such storage method is safe and secure due to backup which ensures that data can be accessed even if the equipment breaks down.
- **Hard copy format method:** The copies of the original documents or the copies of original documents presented in securing credit are kept in files and stored in the format they are in until the contractual agreement is over.

**Procedures**

The procedure for storing the credit security documents is similar to the one for filing the legal documents. However, for the credit security documents, the documents are stored in an accessible place to allow easy retrieval and updating in due process.

**Importance for keeping the security documents**

- For confidentiality purposes.
- To keep track of rights spelt out in the credit advancement.
- For proof purposes in case one party breaches the contract,
- For future reference of the terms of credit.



**5.3 Security documents register is maintained as per credit policy**

The maintenance of security documents register is important that it keeps the required record up to date and that the list of creditors is maintained properly for the credit agency. The credit policy requires that those that have repaid their credit are struck out of the register while those in process of payment are maintained up to their last repayment date. Such documents details can be kept for future reference of the borrowers in determining their credit history.

**Procedure**

The credit policy procedure for maintaining security documents register requires that documents of debtors are withheld until the last installments of the borrowed funds is made. The following procedure therefore applies:

i. Consistently check whether installments have been paid as required and the interests due
ii. Upon payment of the last installment, check the compliance of creditors and debtors.
iii. If all requirements are met, clear the debtors who have paid their last installments and interests.
iv. Return their credit security documents if they belong to the owners and keep that belong to the credit company.
v. Sign the agreement of contract termination and keep details for future use.

**Methods**

i. **Records management:** This is a method embraced when the documents are in soft copy such that the ones that are done with from the register are deleted or transferred to archives where they are stored for future reference.

ii. **Shredding method:** This is applied to security documents register which is in hard copy such that the ones that have been done with are destroyed to create space for new records.

## 5.4 Insurance register is maintained as the credit policy

It is required by the lending policy that every contractual agreement of borrowing is safeguarded by insuring it. Therefore, the insurance register for the credit advanced should be maintained with the periods and amount payments for the insurance.

**Procedure**

i. Requesting information from the insurance firm in regard to premium payments of the debtor.
ii. Updating of records of insurance payments of the debtor in the credit insurance file.
iii. Checking and striking out those members that have completed paying their insurance on loans and no longer have loans with the organization.
iv. Consistent maintenance of records and addition of new records as per the credit policy.



**Importance of maintaining insurance register**

- To ensure that the file is up to date for security of funds borrowed in case of default.
- To ensure that loans given out are consistently in compliance with the credit policy set by the financial institutions governing body.
- To ensure that the loaning organization stands a better chance of recovering the finances loaned out, at any given time.
- Helps in creating good credit history for the borrower in terms of insurance premium payments for loans.

**Importance of maintaining security documents**

- For future references in terms of loaning
- They guide in the orderly clearance of the loaned
- Loan repayments are able to be kept up to date
- List of creditors is well ascertained when the documents are maintained
- Proper credit management is achieved with the maintenance of the documents

## 5.5 Valuation report is maintained as per credit policy

The valuation report is maintained to ensure that the full amount advanced as credit can be recovered from the asset inspected and value in case of loan default. Therefore, the report is maintained through recalculation of the assets' value by subjecting it to conditions such as depreciation if the loan is long term.

**Procedure**

i. Continuously revalue the asset that was originally valued for the acquisition of the loan. This is done through recalculation of the value of the asset through depreciation.
ii. Updating of the report continuously such that the data to be referred to can have the true and fair value of the asset valued.

**Ways of maintaining valuation report**

- Mathematical computation. The asset valuation report can be computed and maintained with the present figures across the loan period.
- Doing away with reports that are no longer in use. Reports whose work has been finished have no use to the lending organization thus can be done away with either by destruction or disposal.

**Conclusion**

The learning outcome covered; maintenance of the credit security documents to completion. The procedures and methods given are standard thus fit across lending firms for the maintenance of such documents. The final practice of maintenance should be destruction of obsolete documents which creates space for new ones. That is the proper and efficient maintenance of such documents.

**Further Reading**



1. Read more on: business law; lending and borrowing policies and the law of contracts

**5.3.6.3 Self-Assessment**

**Written Assessment**

1. Which of the following is not a legal credit document?
   a) Title deed
   b) Loan agreement
   c) ATM card
   d) Credit policy
2. Which of the below is not a filing equipment?
   a) Filing cabinet
   b) Stamp
   c) Filing register
   d) Shredder

3. Which of the following is not a filing method?
    a) Filing by dates method
    b) Geographical filing method
    c) Filing by category method
    d) Filing by importance method
4. Which of the following is an importance of filing?
    a) For record keeping
    b) Keeps the documents free from dust
    c) Prevents the debtor from defaulting
    d) None of the above
5. Which of the following parties' benefits from maintaining security documents register?
    a) Creditor
    b) Debtor
    c) Both creditor and debtor
    d) None of the above
6. Can a valuation report of last year be used for acquiring a loan this year?
    a) Yes
    b) No
    c) Maybe
    d) Don't know
7. Interpret different types of credit needs.
8. Highlight the ways in which credit records are obsolete
9. Analyse the importance of keeping a valuation report.
10. Outline the importance of soft copy documents.
11. Discuss the conditions of loan defaulting.



**Oral Assessment**
1. What is the best way of getting rid of obsolete records?
2. What are the associated costs of maintaining credit documents?

**Practical Assessment**
Learners should visit a nearest loaning facility and practically learn the whole procedure of asset valuation and report generation of the valuation since it forms the basic and material step for determining amount of credit one can access.

**5.3.6.4 Tools, Equipment, Supplies and Materials**
- Writing materials
- Projector
- Computer
- Flip chart/white board
- Computers
- Phones

- Stationery
- Furniture
- List of approved lawyers
- Transport
- Sample credit security documents

#### 5.3.6.5 References


Chatterjee, S. (2017). Record keeping through the ages. IQ: The RIM quarterly, 33(1):40.

Lowe, J. (2018). Managing loans and credit. In essential personal finance (pp. 158-180). Routledge

Oliver G. (2017). Managing records in current record keeping environments. Currents of Archival thinking, 83.