FOUNDATIONS OF CREDIT POLICY DEVELOPMENT AND IMPLEMENTATION

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Introduction. Credit plays a significant role in the functioning of modern economies, especially in facilitating businesses and individuals to access funding for their respective activities. However, such access to credit comes with a risk, and such risks can pose a significant threat to financial stability. Thus, banks and financial institutions need to have a well-defined credit policy in place to ensure responsible lending that maximizes profits while minimizing risks. In this article, we take a closer look at the features of credit policy development and implementation. The credit policy is a comprehensive set of guidelines and principles that enable banks and financial institutions to regulate the creditworthiness of potential borrowers, monitor credit portfolio performance, and enforce risk management practices to mitigate credit risk. There are several features that the credit policy must possess, including assessing the creditworthiness and affordability of borrowers, setting credit limits, monitoring credit performance, and enforcing risk management strategies. Below are some of the critical features of credit policy development and implementation: credit analysis, credit limit setting, credit monitoring and reporting, risk management, and regulatory compliance.

Methodology. This article uses descriptive research to establish the influence of credit policy on the performance of loans of commercial banks. This type of research describes what exists and has a purpose to observe, describe and document aspects of a situation as it naturally occurs. Descriptive research seeks to establish factors associated with certain occurrences, outcomes, conditions, or types of behavior.

Literature review. Credit Unions use the 5Cs model that was developed for credit to evaluate a customer as a potential borrower [Wairagu, 2016, 9]. The 5Cs evaluate a customer's character, capacity, capital, collateral, and conditions of the applicant and how all these affect their ability to repay the loan before disbursing it. The 5Cs help check the ability of the loan applicant to repay the applied amount of credit as and when they fall due thereby increasing the credit performance of the institution [Sarajar, 2013,

4]. This model is used to determine the creditworthiness of potential borrowers solely based on the information declared by the applicant [Kealy, 2014, 8].

Scientific novelty. Only in the case of developing clear guidelines for credit analysis, credit limit setting, credit monitoring, and risk management, banks, and financial organizations will be able to ensure compliance, as well as efficiency of the bank's credit policy and the ever-changing business environment. For financial stability and risk reduction, banks and financial organizations should best develop their credit policy by modern trends and challenges.

Analysis. *Credit Analysis*. Credit Analysis is a systematic and comprehensive process that assesses the creditworthiness and affordability of borrowers. This involves analyzing various factors such as borrowers' income, credit history, and repayment capacity to determine whether they are eligible for credit or not. The credit policy must have well-defined credit analysis procedures that address these factors and ensure that the bank or financial institution is lending responsibly.

Credit analysis is the process of evaluating the creditworthiness of a borrower to determine the likelihood of repayment of a debt obligation. It involves assessing the borrower's financial and credit history, their capacity to repay the loan, and the nature of the loan's collateral. Credit analysis is essential for investors, lenders, and other parties that need to evaluate credit risk.

Credit analysis is typically used by lenders, such as banks, to determine whether to approve a loan application, what the terms and conditions of the loan should be, and the amount of credit to extend to the borrower. Credit analysis is also used by credit rating agencies to determine the creditworthiness of companies and countries.

There are different types of credit analysis, including qualitative analysis and quantitative analysis. Qualitative analysis involves evaluating the borrower's creditworthiness based on non-financial factors such as character, reputation, and management experience. Qualitative credit analysis is the process of assessing a borrower's creditworthiness based on non-financial factors. It involves evaluating factors such as management quality, industry trends, and economic conditions that may have an impact on the borrower's ability to repay the loan. Qualitative credit analysis is typically used in tandem with quantitative credit analysis, which assesses creditworthiness based on financial data. Here are some of the factors that are evaluated in qualitative credit analysis.

The quality and experience of a borrower's management team are important factors in assessing creditworthiness. Qualitative credit analysis looks at factors such as management's vision, track record, and degree of accountability and transparency in making strategic decisions. A borrower's industry, including market size and competition, is also evaluated in qualitative credit analysis. Industry trends can affect a borrower's ability to

repay the loan, and this must be taken into consideration when assessing creditworthyness. Qualitative credit analysis also accounts for the broader economic conditions in which a borrower operates. Factors such as interest rates, inflation, and currency fluctuations can impact a borrower's business and ability to repay the loan. The legal and regulatory environment can also influence a borrower's creditworthiness. Qualitative credit analysis looks at the borrower's compliance with local laws, regulations, and industry standards. Qualitative credit analysis provides a more holistic view of a borrower's creditworthiness than quantitative analysis alone. It helps lenders determine whether a borrower has the management skills, industry knowledge, and economic resilience to repay the loan.

On the other hand, quantitative analysis involves evaluating the borrower's financial statements, including income statements, cash flow statements, and balance sheets, to determine their capacity to repay the debt. Quantitative credit analysis is the process of assessing a borrower’s creditworthiness based on financial data. It involves analyzing financial statements, credit reports, and other financial data to determine the borrower's loan repayment ability. Here are some of the factors that are evaluated in quantitative credit analysis. The borrower's financial statements, including income statements, balance sheets, and cash flow statements, are analyzed to assess their financial health. Key ratios such as debt-to-equity and interest coverage ratios may be calculated. Credit reports are used to evaluate a borrower's credit history and track record of repaying debts. The report may include information on credit card bills, loans, and bankruptcies. If the loan is secured by collateral, such as equipment or real estate, this is also evaluated to determine its value and liquidity. Quantitative credit analysis also involves assessing industry benchmarks and standards to determine how the borrower's financial performance compares to industry peers.

Overall, quantitative credit analysis provides a numerical measurement of a borrower's creditworthiness, allowing lenders to quantify the level of risk involved in extending credit. Credit analysis is based on the Five Cs of Credit, which are character, capacity, capital, collateral, and conditions [Forbes, 2022] The Five Cs of Credit are used to evaluate the borrower's creditworthiness and the risk of default.

Character refers to the borrower's credibility and reputation. The lender evaluates the borrower's history of debt repayment, their reliability, and their honesty when dealing with financial obligations. Capacity refers to the borrower's ability to repay the loan. The lender evaluates the borrower's cash flow, the amount of debt they currently have, their income and expenses, and their employment history to determine their capacity to repay the loan. Capital refers to the borrower's net worth. The lender evaluates the borrower's assets, liabilities, and equity to determine their financial stability. Collateral refers to the assets that the borrower pledges as security for the loan. The

lender evaluates the value and quality of the collateral to ensure that it covers the loan in case of default. Conditions refer to the economic and market conditions that may affect the borrower's ability to repay the loan. The lender evaluates the borrower's industry, economic conditions, and other external factors that may affect their financial position.

In conclusion, credit analysis is the process of evaluating the creditworthiness of a borrower to determine the likelihood of repayment of a debt obligation. Lenders and other parties need to assess credit risk. The Five Cs of Credit plays an important role in the credit analysis process and provides a framework for evaluating creditworthiness and the risk of default.

Credit Limit Setting. Credit Limit Setting involves setting credit limits for borrowers based on their creditworthiness and repayment capacity. The credit policy must ensure that credit limits are set within the borrower's capacity to repay and based on their creditworthiness. The credit policy should also have clear guidelines on how credit limits can be increased or decreased based on changes in borrower circumstances. Credit limit setting is an important aspect of credit risk management. It refers to the maximum amount of credit that a lender or financial institution is willing to extend to a borrower. A credit limit is determined based on the borrower's creditworthiness, which includes factors such as credit history, income, and debt-to-income ratio. The credit limit represents the total amount of funds that the borrower can borrow from the lender, subject to the terms of the loan agreement. The credit limit is usually communicated to the borrower at the time of approval of the loan, and it is adjusted periodically based on changes in the borrower's financial position.

There are different types of credit limits, depending on the nature of the loan. For example, credit cards have a revolving credit limit, which means that the borrower can use the credit limit repeatedly until the limit is reached or the borrower defaults. Some common factors that lenders consider when setting credit limits include the borrower's income, employment status, credit history, and existing debt obligations. Lenders may also consider the borrower's relationship with the lending institution, the borrower's repayment behavior, and the purpose of the loan.

Credit limit setting is important because it helps lenders manage credit risk. By setting a credit limit, the lender can ensure that the borrower does not borrow more than they can afford to repay, which reduces the risk of default. The credit limit also helps lenders manage their financial resources by limiting the amount of funds they have at risk with a borrower. Credit limit setting is also important for borrowers. By knowing their credit limit, borrowers can plan their borrowing and repayment strategies, and ensure that they do not exceed their credit limit, which can have negative consequences such as penalties and fees.

In conclusion, credit limit setting is an important aspect of credit risk management. It helps lenders manage credit risk and ensures that borrowers do not borrow more than they can afford to repay. Various factors are taken into consideration when setting a credit limit, including the borrower's credit history, income, and debt-to-income ratio. By understanding credit limits, borrowers can make informed borrowing and repayment decisions.

Credit Monitoring and Reporting. Credit Monitoring and Reporting involve tracking the credit performance of borrowers to ensure their adherence to the credit policy's principles. The credit policy must have a well-defined credit monitoring process that tracks various parameters, including repayment histories, outstanding debts, and other relevant metrics. The credit policy should also set clear guidelines for reporting and managing credit losses and defaults.

Credit monitoring and reporting are critical components of credit risk management. Credit monitoring involves tracking the credit performance of a borrower to identify signs of potential default or delinquency. Credit reporting involves reporting credit information to credit bureaus and other stakeholders to assess creditworthiness and manage credit risk. Credit monitoring involves a regular review of a borrower's credit history and financial situation. This can include monitoring payment history, credit utilization, and debt-to-income ratio. It can also include reviewing credit reports, bank statements, and other financial documentation to identify any changes that could impact the borrower's ability to repay their debts. Credit reporting involves reporting credit information to credit bureaus and other stakeholders who may use this information to evaluate creditworthiness and manage credit risk. Credit reporting agencies collect information on a borrower's credit history, including payment history, outstanding debts, and creditworthiness. This information is used to calculate credit scores, which are used by lenders and other stakeholders to assess the borrower's creditworthiness.

Credit monitoring and reporting are important because they help lenders manage credit risk. By monitoring a borrower's credit performance, lenders can identify early warning signs of potential delinquency or default, and take appropriate action to mitigate the risk. Credit reporting helps lenders and other stakeholders assess creditworthiness, which is essential for making informed decisions about lending and other credit-related transactions.

In addition to managing credit risk, credit monitoring and reporting also help borrowers manage their credit. By monitoring their credit history, borrowers can identify areas for improvement, such as paying bills on time and reducing their debt-to-income ratio, which can help improve their credit scores over time.

Overall, credit monitoring and reporting are essential components of credit risk management. They help lenders and other stakeholders assess creditworthiness, manage credit risk, and make informed decisions about lending and other credit-related transact-tions. For borrowers, credit monitoring and reporting can help improve their credit standing and manage their debts more effectively.

Risk Management. Risk Management involves identifying, assessing, and mitiga-ting credit risk. The credit policy must have well-defined risk management strategies that identify and mitigate credit risks. The credit policy should also include guidelines for managing credit risks arising from external factors such as economic fluctuations, regulatory changes, and other market dynamics. Credit risk management refers to iden-tifying, assessing, and mitigating the risk of default or loss arising from lending active-ties. It involves implementing strategies and policies that reduce credit risk and ensure that lending activities are profitable and sustainable.

Credit risk management is important for financial institutions, such as banks and other lenders, as it helps them manage the risk of losses resulting from non-payment of loans. Credit risk management includes several components: credit analysis, credit limit setting, credit monitoring and reporting, and risk mitigation strategies.

Credit analysis involves assessing the creditworthiness of potential borrowers, in-cluding their credit history, income, and debt-to-income ratio. This information is used to make decisions on whether to approve a loan application, what the terms of the loan will be, and the amount of credit to be extended to the borrower.

Credit limit setting involves determining the maximum amount of credit that a borrower can receive, based on their creditworthiness and ability to repay the debt. Credit limits are set based on an assessment of the borrower's financial position, as well as their credit history and other factors that may impact their ability to repay the debt.

Credit monitoring and reporting involves tracking the credit performance of borro-wers to ensure that they are adhering to the terms of the loan agreement and that timely repayments are being made. Credit monitoring can involve reviewing credit reports, bank statements, and other financial documentation, as well as monitoring the borrower's payment history, credit utilization, and other factors that may impact their ability to repay the debt.

Risk mitigation strategies involve implementing measures that reduce the risk of credit loss or default. This can include diversifying the credit portfolio, implementing risk management policies and procedures, and implementing measures to detect and prevent fraud and other types of financial crime.

Regulatory compliance. Financial institutions must comply with regulatory requirements set by government agencies. Regulatory compliance is an essential feature of credit policy in all countries, and financial institutions must follow established guidelines in developing and implementing their credit policies.

Regulatory compliance is an important aspect of credit policy. Credit policies need to comply with relevant laws and regulations to ensure ethical and legal lending practices. Here are some of the regulatory compliance requirements that credit policies need to adhere to: *Truth in Lending Act (U.S.), Consumer Credit Act (U.K.), Fair Credit Reporting Act (U.S.), and Personal Data Protection Act (Singapore).*

The Truth in Lending Act (TILA) is a U.S. federal law that requires lenders to disclose important information about credit terms and costs to consumers. The TILA covers loans such as mortgages, credit cards, and private student loans. The Consumer Credit Act is a U.K. law that regulates consumer credit agreements, such as credit card agreements and personal loans. The law requires lenders to disclose the loan's interest rate, charges, and other conditions before the loan is accepted. The Fair Credit Reporting Act (FCRA) regulates credit reporting companies and ensures that consumer credit reports are accurate. Under the FCRA, consumers have the right to dispute and correct errors on their credit reports. The Personal Data Protection Act (PDPA) in Singapore regulates the collection, use, disclosure, and protection of personal data by organizations. The Act ensures that personal data, including credit information, is collected and processed by privacy principles.

By adhering to these and other relevant laws and regulations, credit policies can help ensure that lenders engage in ethical, transparent, legal lending practices. Regulatory compliance also helps protect consumers from abusive lending practices and fraud.

Conclusion. Credit risk management is an essential component of lending activeties, ensuring that lenders assess and manage risk responsibly and effectively. Credit risk management helps ensure the safety and soundness of financial institutions while allowing them to serve their customers in a way that supports their financial goals and objectives.

Credit policies differ from country to country but they are generally put in place to regulate lending practices to manage risk, promote financial stability, and protect consumers.

In conclusion, a well-defined credit policy is essential for responsible lending, risk mitigation, and financial stability. Banks and financial institutions must ensure that their credit policies have clear and well-defined guidelines for credit analysis, credit limit setting, credit monitoring, and risk management. In today's dynamic business environ-

ment, credit policies must be regularly reviewed and updated to ensure their relevance and effectiveness.

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Foundations of credit policy development and implementation

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Ensuring financial stability, first of all, implies defining the fundamental directions of the credit policy implemented by banks, defining the management structures of banking and external (general) risks arising during their activity, and acting as one of the priority tasks of all central banks of the world. The quality of the bank's management is ex-pressed by the existence and content of the bank's policy, the rational organization of the bank's structure, which allows for solving strategic and current problems at a high level, related to the development of the appropriate mechanism for the management of assets and liabilities, many processes related to the adoption of the most responsible mana-gerial decisions. with a clear definition of content. What is important is not only having a formal policy but how much that policy contributes to the bank's operations. The policy should correspond not only to the specific characteristics of the bank but also to the strategic issues. The scope of the policy may vary depending on the size of the bank, the nature of operations, and the services provided. It should contribute to the coordi-nation of the activities of the relevant structural divisions of the bank, including plans for overcoming unforeseen cases and unforeseen situations. Therefore, we found it appropriate to study the credit policy development and implementation criteria and their characteristics in international banking practice.