DECALOGY OF COOPERATIVES MANAGEMENT

9 MANUAL ON CREDIT RISK MANAGEMENT FOR COOPERATIVES

ABSTRACT

The manual contains the needed organizational structure and policy environment that every credit and saving cooperative must adhere to effectively manage credit risks. It contains the expected roles and responsibilities of different players – units and positions, including the Board of Directors, involved in the credit management of a cooperative.

ACKNOWLEDGEMENT

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TABLE OF CONTENTS

I. FOREWORD

The overall objective of this manual is to demonstrate how cooperatives should design and develop their credit policies in order to eliminate credit risks related to their credit or loan programs to its member-borrowers.

Following the credit management framework of NATCCO, this manual is configured based on the four components of the framework where the entire intention is to manage credit risk (risk management) – the center of the entire process.

The manual will introduce the cooperatives to the different components of the credit management framework by first demonstrating the needed organizational structure supportive to a cooperative's credit risk management (see diagram below), followed by the four parts or components of the framework with sample policies and guidelines.

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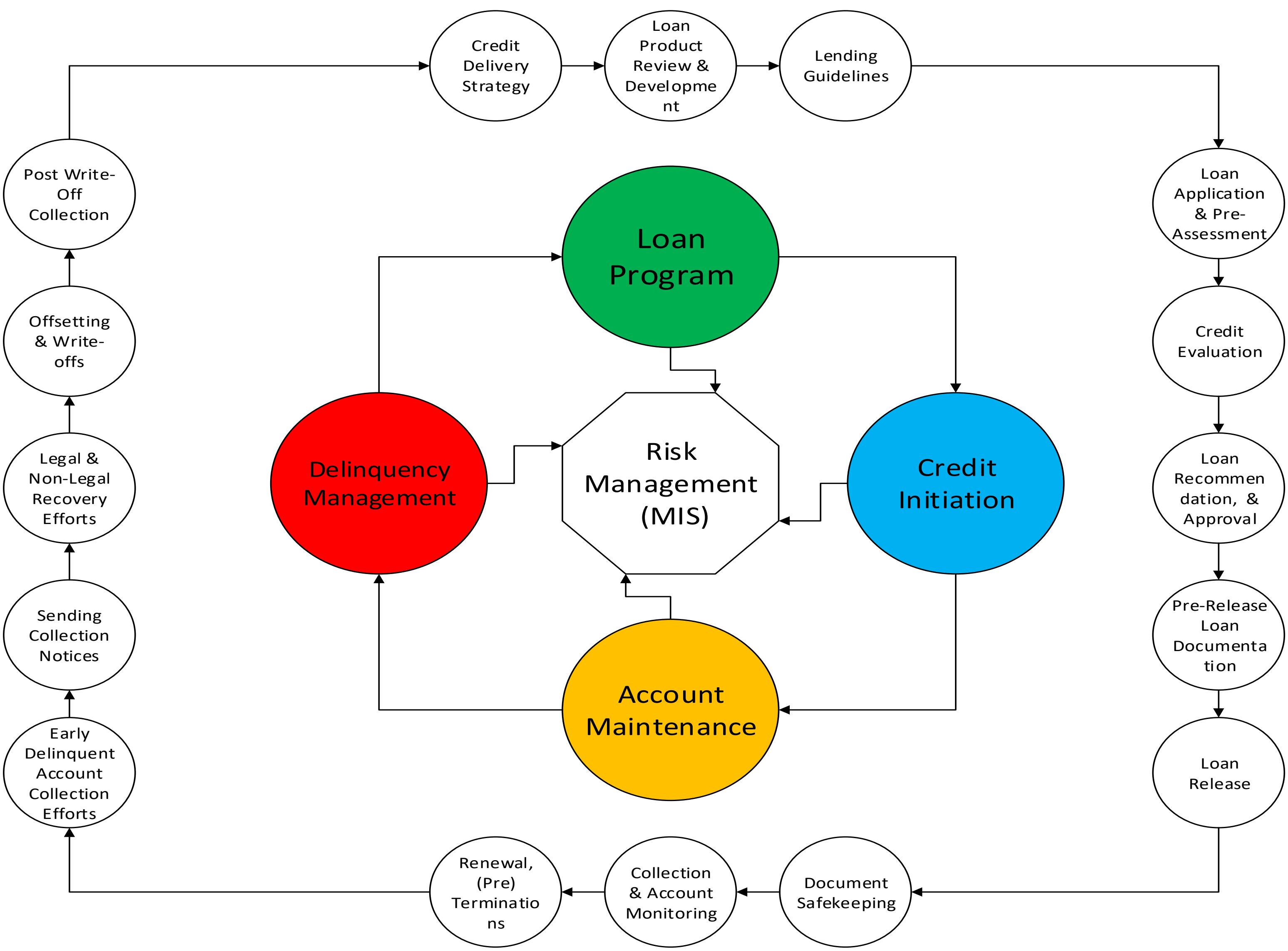
Credit Risk Management Framework



THE NEED FOR APPROPRIATE ORGANIZATIONAL STRUCTURE TO EFFECTIVELY DELIVER THE CREDIT RISK MANAGEMENT FRAMEWORK

An appropriate organizational structure is necessary to support a cooperative's credit risk management framework. The structure shall be designed to ensure that policies and procedures are established and implemented within tolerable risk parameters.

A. Department and Units of a Cooperative's Credit Structure

There are six main functional units that are necessarily present in the credit structure of the cooperative so an appropriate credit risk environment can be created. They are as follows:

1. Oversight and Supervision

   The Board of Directors and Senior Management are principally responsible for the oversight and supervision of credit operations. They perform the following functions:

   a. Set the strategic direction of the cooperative that are translated into risk limits, policies and procedures.
   b. Approve the organizational structure of the cooperative that is aligned with the size and complexity of its operations to effect efficient and effective credit management.
   c. Design and approve the loan programs of the cooperative.
   d. Provide tools and resources that will ensure the execution and implementation of the aforementioned.

2. Sales

   The sales function is the responsibility of the branch, performed mainly by the branch managers and account officers. It is considered the front office of credit. The main goal of the sales unit is to generate new loans and increase the portfolio which they can achieve by developing a strong membership base and member relationships.

   The branch sales unit can also serve as the research arm of the marketing department of the cooperative by providing the latter with information about the evolving nature of the market, competition and membership needs.

3. Control (Credit Management)

   The credit control function is a major contributor t0 the success of credit operations. Personnel performing credit control should be skilled and specialized in their functions. The credit control unit includes all personnel involved in credit initiation and account maintenance, so they play key roles in maintaining good portfolio quality.

The goal of the control unit is to ensure timely repayment of loans to be granted; hence, reduce, mitigate and/or avoid the risk of default of loan applications generated by the sales

unit. It generally involves the review of documentations, valuation of collateral, evaluation of the borrower and establishing loan covenants.

The control unit shall also perform collections of loans granted to realize profits in completion of the credit transaction initiated by sales.

To avoid conflict, it is necessary that there must be mutual understanding between sales and control of their respective roles in the achievement of organizational goals.

Sales and control functions cannot be performed by the same person or unit to maintain check and balance of all loan transactions.

4. Remedial Management

Remedial Management is the function that addresses the collection or recovery of written off and hardened accounts. It can be a specialized unit or department whose objective is to ease the burden of collection and recovery efforts from the control unit giving them more time to invest in maintaining good quality accounts. The remedial unit shall manage the portfolio of distressed loans to minimize loss and maximize recoveries for the cooperative.

5. Legal/Paralegal Unit

This is the unit that manages the delinquent accounts subjected to legal action by the remedial unit. Its main responsibility is to liaise with external and internal lawyers to ensure quick filing of legal action and expeditious resolution of legal cases.

6. Compliance and Internal Audit

The credit structure has to provide for compliance and internal audit. These are independent credit review functions that assess the quality of the portfolio and adequacy of loan loss provisioning. This unit shall also perform audit of the credit risk management system of the cooperative in terms of its effectiveness and efficiency.

B. Duties and Responsibilities of a Cooperative's Credit Structure

It is the policy of the cooperative to ensure that credit risk taking activities of the organization are supported by an appropriate credit risk management structure. The cooperative's credit structure supports the separation of the loan sales generation and loan control functions to ensure the high quality of the portfolio.

The credit structure of the cooperative shall be based on specialization, and aims to meet the following objectives:

1. Division of duties and responsibilities separating sales from control functions;
2. Clear delineation of lines of authority and definition of accountabilities in each phase of the credit cycle;
3. Establishment of a risk-based credit environment that ensures check and balance across all functions; and
4. Generation and maintenance of a high quality loan portfolio.

The following are the duties and responsibilities in a cooperative's credit structure:

1. Board of Directors

It is the overall responsibility of the Board to approve the cooperative's credit risk policies and strategies, which are reviewed annually to ensure effectiveness. The Board also sets the credit risk tolerance level of the cooperative to ensure that its credit exposure is maintained at prudent levels and consistent with available capital and resources. They ensure that the credit system provides for adequate procedures and processes to identify, measure, monitor and control all credit risks inherent in the loan product offerings of the cooperative.

2. Senior Management

Management ensures that credit risk-taking activities of the cooperative are aligned with the Board-approved strategies and risk tolerance limits. It is their responsibility to ensure effective implementation of credit policies by developing procedures that lay down the conditions and guidelines for an effective credit risk management process. These procedures, when approved by the Board, must be clearly communicated and adhered to by all levels of the organization.

3. Branch Operations

   a. Branch Manager

The Branch Manager is the main credit sales channel of the cooperative. S/He analyzes potential loan markets and develops referral networks in order to locate prospects for loans. The primary function of a branch manager is to create and maintain member relations. His/her sales function is an integration of membership, savings and loans. S/he is also administratively responsible for loan control personnel deployed in their respective offices.

   b. Account Officer

The Account Officer's main task is to improve the loan structure of the cooperative by generating new loans. S/He is expected to stay abreast of various types of loans and other financial services and products in order to better meet members' needs. However, s/he is also responsible in maintaining the quality of said loans through proper loan monitoring and maintaining strong member-borrower relations.

The Account Officer prepares the loan package, including its rate, term and mode of payment, on the basis of the credit risk of the applicant. S/He matches the loan tenor and repayment schedule to the purpose of the loan and cash flow of the applicant. S/He also confers with the Credit Analyst for any flexible pricing strategy that can be offered to the applicant and evaluates its feasibility. S/He prepares the written Credit Proposal for presentation and approval of credit approving authorities.

4. Credit Management Unit

   a. Loans Processor

The Loans Processor undertakes an intermediary role between potential member-borrowers and the cooperative. S/He responds to inquiry of members regarding the cooperative's credit facilities. S/He acts as a loan counselor by identifying the financial needs of the members and suggesting the appropriate type of loan for them.

The Loan Processor also collects all required documentation for loan applications and performs initial determination of the credit worthiness of applicant-borrowers based on set pre-assessment guidelines. Likewise, the Loans Processor is responsible for records management ensuring that all borrower files and loans database are complete, updated and properly maintained.

b. Credit Investigator

The Credit Investigator undertakes comprehensive assessment of the credit, financial, personal and business background and history of the applicant-borrower to determine whether they make good candidates to borrow money. The Credit Investigator measures the credit risk entailed in the loan application. S/He validates authenticity of documents and information provided and discovered using various methods, but not limited to credit checking and evaluating financial statements/cash flows. The CI Report shall be utilized by the Account Officer as a basis for loan approval recommendations.

c. Credit Appraiser

The Credit Appraiser evaluates and analyzes the assets provided by the applicant offered as collateral. S/He is responsible for evaluating the acceptability and condition of the asset. S/He renders a sound estimate of peso value to the asset using a systematic and analytical approach.

d. Credit Analyst

As the main credit underwriter, the Credit Analyst evaluates applicants' character, financial status, credit history, and property evaluations to determine feasibility of granting loans. S/he is responsible in determining the credit risk score of potential member-borrowers where the Account Officer shall base his/her recommendations in the loan packaging phase of the loan.

e. Loan Documentation Specialist

The Loan Documentation Specialist is responsible in pre-release documentation of duly approved loans. S/he is responsible in drafting loan agreements, mortgage contracts, and other loan covenants in compliance with the terms and conditions stated in the loan approval memo.

f. Collectors

Collectors are responsible for field collection as a legitimate payment option available for member-borrowers. They are responsible for the periodic monitoring of accounts assigned to them, where any significant credit information shall be reported to the Account Officer.

5. Remedial Management and Asset Recovery

a. Remedial Management and Asset Recovery Specialist (RARS)

The RARS handles hardened delinquent accounts isolated from branches. Their main duty is to effectively enforce collection activities on “hard accounts” and recovery actions on written-off accounts. The RARS is tasked to initiate remedial and/or legal actions against delinquent borrowers for purposes of collection and recovery.

Part 1: LOAN PROGRAM

There are three policy classifications to be used in developing a loan program:

1. Policy on Product Review and Development
2. Policy on Lending Guidelines
3. Policy on Credit Delivery Strategy

A. Product Review and Development

Policy on Loan Categories

In developing this policy along the lines of product review and development, the succeeding statement of policy and purpose could serve as a reference for cooperatives.

Statement of Policy

It is very important that the cooperative has clear and well-defined loan types in order to offer the products that best meet the financial needs of potential member borrowers. All credit personnel must have a common understanding of the cooperative’s product line to enable them to effectively match the purpose of each loan application to the most relevant loan product.