# CHAPTER 9

# BANKS AND LENDING

☸ *Objectives:*

**9.1 Introduction**

**9.2 Analysing a new lending proposition**

**9.3 Lending money**

**9.4 Credit analysis**

**9.5 Working capital analysis and financial projections**

## 9.1 Introduction

Lending money is one of the basic functions of a bank. It is the interest earned from banks that brings in most of the revenue to pay the expenses, including staff salaries of the bank and give a sufficient surplus to pay shareholders a dividend and retain funds in reserves accounts for expansion of the bank.

For the Romanian banks, there are the following sources of funds:

- **bank deposits** (in Romania about 70%-90% of the volume of funds) divided in:

  **Short-term bank deposits* expressed in domestic currency (ROL), or foreign currency;

  **Long term bank deposits* expressed in domestic currency (ROL), or foreign currency;

- **borrowed funds** including:

  * *Loans borrowed* from other banks (in domestic or foreign currencies);

  **Refinance* of the National Bank of Romania, which has the following forms[1]:

- structural credit;
- auction credit;
- special credit;
- credit granted with derogation from regulation;
- Lombard credit;
- preferential credit (frozen credit from 1993 to be reimbursed);

- **own funds**[2] including:

  **Own capital (*paid up capital; reserve fund, profit, other funds);

  **Supplementary capital* (risk fund, other funds).

---

[1] National Bank of Romania – Regulation no. 1/2000 concerning the transactions on the monetary market realised by the NBR, issued in Monitorul Oficial al României no. 142/2000.

[2] National Bank of Romania – Norms no. 7/1999 concerning the own funds of banks, issued in Monitorul Oficial al României no. 206/1999,

**It should be remembered** that the funds that are put out on loans belong to customers. It is their money that is put at risk, so that if a bank is continually making bad or unprofitable loans, this will sooner or later be reflected in the deposits.

Before giving an advance, it is necessary for the manager *to know the purpose of the loan.*

The lending officer may wonder whether the loan is for a legal purpose, or not.

***A loan*** means immediate possession of resources in exchange of a future payment promise involving also an interest payment that rewards the lender.[3]

Types of credit or loan

Generally, banks have their specific lending policies, which may change from time to time due to the market conditions or government regulations. Their policies are essentially based on the evaluation of the related risks such as the credit risk, interest rate risk and concentrated risk. The lending may be also authorised at a branch level if the branch portfolio allows that.

In order to make proper lending decisions, banks purposely observe a set of general lending principles such as age and state of health, stability, integrity and honesty, sources of income, regular expenditure, existing connections, ability to manage financial affairs as well as margin, purpose, amount, repayment capability and security.

As corporations, companies, individuals or the government represent the category of bank customers; the types of loans vary accordingly and can be generally divided into country loans, business loans and personal loans.

**Country loans**

So, as to be able to achieve national political, social and economic goals, governments may need finance and, in this respect, the international financial institutions are expected to grant them a large variety of loans including apex, distressed, economic recovery, emergency reconstruction,

---

[3] Basno Cezar, Dardac Nicolae, Floricel C.- Monedă, Credit, Bănci Ed. Didactică şi Pedagogică, Bucureşti, 1994

sovereign, standby loans as well as balloon, call, carryover, equity, hard and soft loans, colons, indexed, outstanding, jeopardy, jumbo, non-accruing or non-performing loans, overage, participation and package loans, pipeline, pooled, premature, programme, project and sector loans, secured, quality, quick disbursing loans, senior, subsidiary, syndicated, time-slice, top-rated, revolving, working capital loans, sub-loans etc.

**Corporate lending**

As corporations and companies represent the major category of clients, for the corporate lending banks do analyse a set of basic and additional criteria such as the ability of continuing business, the expected future cash flows, security and collateral, the rate of return to the bank as well as the level of the whole business which the bank has done with them.

The usual procedures which banks apply in the loan granting to corporate borrowers specifically include submission of the application and required information, evaluation of the information, initial evaluation of the proposed security, negotiation, approval, legal examination of the security, signing of the contract, disbursement of the amount and recovery of the capital and interest.

The credit granted to companies, whether public or private, generally comprises loans for working capital and for fixed assets, financing such as overdrafts, term loans, syndicated loans, and revolving credit and working capital loans.

**Loans for Working Capital:**

**Overdrafts**

Overdrafts are usually granted to those companies desirous to use the credit amount not as a whole but rather in accordance with their needs and for a certain period without having to pay interest on the entire amount but on the term agreed for interest calculation. In such cases, whenever the company gets excess of capital it can repay parts of the credit and, consequently, decrease the amount outstanding.

**Export Financing**

As most major companies deal with exports, banks can offer short time credit to exporters until they recoup the money from importers, upon a collectibles guarantee for the lending bank.

**Loans for Fixed Assets Financing**

Such loans essentially include short-term, medium-term and long-term loans with respect to maturity. The security for such a lending may be uncovered, covered by cash equivalent, by personal guarantees or mortgage assets, collateral and, according to the type of repayment, it may comprise equal capital amortisation, equal instalment payment, specific terms, fixed or floating interest etc. When loans in foreign currency are expected to be granted, banks usually tend to hedge their positions in the foreign currency but, very often, they rather speculate.

**Syndicated Loans**

Unlike the participation loans, the syndicated ones consist of an agreement specifying that two or more banks accept to directly lend to the same borrower or borrowers. In such a case, one of the banks plays the role of the agent bank while the others participate by own portions in the syndicate, the risks being shared by all of them.

**Retail Lending**

Besides the corporate lending, the personal lending is also an important activity of banks. Before credit is granted to individuals, the bank thoroughly analyses the income status of the applicant, the stability, the permanency of his or her cash inflows, guarantees by third parties as well as the existing collateral.

The usual procedures in the lending to individuals include the receipt of the applications and required information, evaluation of the collectibles and collateral, decision on the loan amount, approval from the proper committee, legal evaluation and examination of the collateral, signing the contract and disbursement of the amount. Specifically, the retail lending includes the categories of consumer credit and house financing.

**The Consumer Credit**

Individual borrowers, including professionals, sole traders, partnerships, students and youth, clubs, associations and societies may be granted personal loans, including the following facilities: overdrafts, credit card, revolving credit, acceptance credits, hire purchase, conditional sale, credit sale, probate advances, instalment and non-instalment credit. Under such arrangements, the interest rate may be fixed, variable, obtained either at the sale point or at the bank.

**Personal Loans**

They are of a fixed amount, for a fixed period of time and at fixed interest rates and they are usually spent on the purchase of personal items, travels, holidays etc.

These are rather similar to loan accounts, with regular payments, mentioning that the interest on the total loan is calculated before the advance is given, then once it has been accepted, the principal and interest are debited to the loan account and the customer repays the total sum by regular instalments. No security is required for a personal loan as most banks will incorporate some form of insurance, so that in the event of the customer's death, there will be no charge to his dependants.

**Overdrafts**

Banks can grant overdrafts to individual customers at an agreed interest rate. Under such a facility, the borrower can take the needed amount for a particular desired period and does not have to pay interest on the entire amount. Thus, an overdraft occurs when a customer is permitted by the bank to have a debit balance on the current account, up to an agreed amount. Interest is charged at a given percentage above the base rate.

**Loan accounts**

Loans are another way of lending money. For this method a loan account is opened with a credit to the current account and a debit to the loan account. Repayments are usually by regular monthly debits to the current account and credit to the loan account. Interest is charged either quarterly or half yearly to current account or loan account at the option of the customer.

This method is particularly useful where the customer wishes to make regular payments on the amount borrowed, while from the bank's point of view the monitoring of a loan account is easier than an overdraft. Loans are often given to businesses for the purchase of fixed assets or to an individual for the purchase of customer durable goods.

**Credit Cards**

The facility of the credit card enables the customer to borrow up to certain limited amounts either at lending places or at points of sale and to withdraw cash from cash dispensers whenever he wants.

**Budget accounts**
This account is for those persons who find it difficult to monitor their expenditure. It is a form of borrowing and the interest is incorporated in the bank's overall charges.

**Revolving Credit**
Under such an arrangement, customers disposing of such types of accounts are given the option of borrowing amounts up to a certain multiple of their deposit.

Some banks offer the customer an arrangement in which he or she places a regular amount of money into this account and then has the facility to withdraw, without further authority, up to thirty times the regular credit.

**The House Financing**
Specifically, the amounts lent by banks for house financing represent a certain percentage of the house total value and the repayment period vary from 15 to 50 years. The interest rate is also variable and essentially is based on short-term and long-term rates determined as rollover mortgages. The ***repayment patterns*** *of* such loans include the following types: **annuity mortgages** with constant monthly instalments, **endowment mortgages** repaid at maturity upon a life assurance contract, **only-interest mortgages** for a certain period, **gradually increasing payments** and **linear mortgages** with equal capital repayments and decreasing interest.

***Credits*** actually represent the relation between two entities in which one entity has the money (creditor) and gives to the other entity (debtor) a certain sum of money that the latter has to return in an agreed time period and under certain conditions. Based on this, the credits in the Romanian business banking system are classified by the following characteristics[4]:

1) *Depending on the maturity date*:
- short-term credits;
- medium-term credits;
- long-term credits.

2) *Depending on the type of insurance*:
- non-insured credits;
- insured credits.

---

[4] Dr. Cirovic M.: Theory on Credits, Skoplje 1996

3) *Depending on the type of creditors*:
- banking credits;
- commercial credits.

4) *Depending on the type of debtors*:
- agricultural credits;
- industrial credits;
- real estate credits;
- personal credits.

5) *Depending on the type of destination*:
- consumer credits;
- commercial credits;
- industrial credits;
- credits for starting up companies;
- credits for operations with the papers of value, investment credits;
- seasonal credits;
- importing credits;
- exporting credits;
- construction loans;
- small business loans.

6) *Depending on the domicile of creditor*:
- domestic;
- foreign.

7) *Depending on the domicile of creditor.*
- Fixed interest rate loans;
- Variable interest rate loans;
- Floating interest rate loans.

8) *Revolving lines of credits etc.*

## 9.2 Analysing a new lending proposition

There are five stages[5] to any analysis of a new lending proposition:

1. Introduction of the customer;
2. The application by the customer;
3. Review of the application;
4. Evaluation;
5. Monitoring and control.

*Introduction*
Lenders do not have to do business with people they do not feel comfortable with.

An important source of new business for most lenders is introductions from professional advisers such as accountants and solicitors. But, a bank is not obliged to lend to customers introduced in this way.

*The application* (see Annex No. 1) can take many forms but should include a plan for repaying the loan and an assessment of the contingencies, which might reasonably arise, and how the borrower would intend to deal with them.

It might be in detailed written form, or not.

*Review of the Applicaton*
During this stage all the information must be tested. It is sometimes difficult to remember all the points to be covered during an interview and many lenders use a check list (a mnemonics) including:

- character (about the individual's character);
- capital;
- capability/ability;
- purpose/destination;
- amount;
- repayment;
- terms;
- security/insurance.

[5] Bankers' lending techniques issued by the Chartered Institute of Bankers, London 1994.

Ability - this aspect relates to the borrower's ability in managing financial affairs and is similar to character (about skill, experience of the manager).

**Purpose - The lender will want to verify that the purpose is acceptable (legal, moral etc.).**

Amount - Is the customer asking for either too much or too little? There are dangers in both and it is important therefore to establish that the amount requested is correct. The amount requested should be in proportion to the customer's own reasons and contribution.

Repayment - It is important that the source of repayment is made clear. Where the source of repayment is income, the lender will need projections to ensure that there is a surplus of funds to cover the repayment after meeting other commitments.

Insurance - The canons of lending should be satisfied of available security.

Evaluation - The aim of the evaluation is to establish the risk involved. Listing the pros and cons of a proposition is helpful.

As *a summarise*, It should be mentioned that before any loan is granted, the following questions must be answered by the customer:

- how much is required?
- the purpose of the loan (legal, moral and within the policy of the government and the bank, National Bank of Romania);
- length of time the advance is requested? (how long the money is required and whether the outstanding debt will be repaid monthly, quarterly etc).
- the source of repayment - the answer to this question is important to the bank. Any customer must have sufficient resources to repay (capital + interest) the bank within the stipulated agreed time. The sources of the repayment could be from wages, dividends, an inheritance, profits and so on.

## 9.3 Lending money

Banks have as one of their basic functions *lending money* to both physical and juridical persons. The banks charge a certain interest rate on these loans, that represents the earnings used to pay expenses, such as salaries and wages of the workers, rents, other administrative expenses, give interest payments to those holding their money in deposits at the bank, pay shareholders dividends and also retain funds as reserves for the own expansion of the banks.

**Bank loans finance different groups in the economy. Manufacturers, distributors, service firms, farmers, builders, homebuyers, commercial real estate developers, consumers, and others all depend on bank credit. The ways in which banks allocate their funds can strongly influence the economic development of the community and nation. Every bank bears a degree of risk in its granting of credit, and, without exception, every bank experiences some loan losses when certain borrowers fail to repay their loans. Whatever the degree of risk taken, loan losses can be minimised through highly professional organisation and management of the lending function.**

The composition and quality of a bank's loans should be reflected in its loan policy. The policy sets out the bank's lending philosophy and specifies procedures and means of monitoring lending activity. A written loan policy should serve to obtain three results:

- produce sound and collectible loans;
- provide profitable investment of bank funds;
- encourage extensions of credit that meet the legitimate needs of the bank's market.

A meaningful loan policy will express strategies in concrete terms. The desired loan mix should be quantified. The loan mix expresses the diversification sought by the bank in its loan placements. Diversification reduces the level of default risk that is associated with large concentrations of loans in a single category.

The bank's liquidity strategy should be indicated, because it acts as a constraint on lending activity and because liquidity is partly determined by the maturity structure of the loan portfolio. The desired size of the loan portfolio expresses the bank's intended aggressiveness in expanding its loan portfolio. A highly aggressive loan policy has both a bright side and a dark side. The bright side is that a large loan portfolio might increase bank earnings. The dark side is that an aggressive policy might lead to lower credit standards, marginal loans, and an unacceptable amount of risk.

Most borrowers are exposed to risks that threaten their ability to repay their bank loans. Key-man life insurance is especially important to protect against loss if death or disability strikes the borrower or one of the borrower's indispensable employees. A catastrophic fire or flood may interrupt the borrower's business or destroy the loan's collateral.

The loan policy should indicate the types of borrowers who must be insured. The policy must designate the bank as the loss payee, or when the cash value of a life insurance policy is offered as protection, it must be properly assigned to the bank. An increasingly common form of protection is the credit life policy written by the bank. It is simply term life insurance written on consumer loan customers. It pays off outstanding balances due to the bank in the event of the customer's death. A somewhat different form of protection is obtained through reinsurance. If the borrower defaults, reinsurance pays out and the insurance company pursues collection on its behalf on the bank's defaulted note. Reinsurance premiums are rather costly, and policy should indicate what classes of borrowers, if any, should be under reinsurance programs.

Most banks conduct loan reviews to reduce losses and monitor loan quality. Loan reviews consist of a periodic audit of the on-going performance of some or all of the active loans in a bank's loan portfolio. Its essence is credit analysis, although, unlike the credit analysis conducted by the credit department as part of the loan approval process, credit analysis in loan review occurs after the loan is in the books. Other than its basic objective of reducing loan losses, some intermediate objectives of loan review are as follows:

- to detect actual or potential problem loans as early as possible;
- to provide incentive for loan officers to monitor loans and report deterioration in their own loans;
- to enforce uniform documentation;
- to ensure that loan policies, banking laws, and regulations are followed;
- to inform management and the board about the overall condition of the loan portfolio;
- to aid in establishing loan loss reserves.

Whatever means are used to conduct loan reviews, the following points should be covered:

- financial condition and repayment ability of borrower;
- completeness of documentation;
- consistency with loan policy;
- perfection of security interest on collateral;
- legal and regulatory compliance;
- apparent profitability.

When a problem loan is detected, the responsible officer should take immediate corrective action to prevent future deterioration and minimise potential loss.

## 9.4 Credit analysis

Credit analysis is the process of assessing the risk of lending to a business or individual[*]. The so-called credit risk must be evaluated against the benefits that the bank expects to derive from making the loan. The direct benefits are simply the interest and fees earned on the loan and possibly, the deposit balances required as a condition of the loan. Indirect benefits consist of the initiation or maintenance of a relationship with the borrower that may provide the bank with increased deposits and demand for a variety of bank services.

Credit risk assessment has both qualitative and quantitative dimensions; the former are generally the more difficult to assess. The steps in qualitative risk assessment are primarily gathering information on the borrower's record of financial responsibility, determining his or her true purpose for wanting to borrow funds, identifying the risks confronting the borrower's business under future industry and economic conditions, and estimating the degree of commitment the borrower will have regarding repayment. The quantitative dimension of credit risk assessment consists of the analysis of historical financial data and the projection of future financial results to evaluate the borrower's capacity for timely repayment of the loan and,

---

[*] Source: Murray, Andrew – Credit Analysis, Eastern Publishing Ltd., 1998

indeed, the borrower's ability to survive possible industry and economic reverses.
The essence of all credit analysis can be captured in four basic factors or lines of inquiry:

- the borrower's character – most bankers agree that the paramount factor in a successful loan is the honesty and goodwill of the borrower;
- the use of loan funds – determining the true need and use of funds requires good analytical skills in accounting and business finance;
- primary source of repayment – the analyst's accounting and finance skills are crucial in determining the ability of the borrower to repay a loan from cash flows. He must ascertain the timing and sufficiency of these cash flows and evaluate the risks of cash flows falling short.
- secondary source of repayment – the collateral value should cover, in addition to the loan amount and interest due, the legal costs of foreclosure and interest during foreclosure proceeds. Even if the collateral is the preferred secondary source of repayment, others can be guarantors and co-makers, but in such cases, the collection usually requires expensive litigation and results in considerable ill will between the bank, borrower, and guarantor.

In credit investigation, banks usually resort to the following sources of information:

- customer interview – it provides the most important information needed in credit investigation, including the type and amount of the loan required, sources and plans of repayment, eventual collateral and guarantors, previous and current creditors, primary customers and trade suppliers, accountants, main officers and shareholders etc.
- internal sources – credit files on any current or previous borrowings, checking account activity, other previous or current deposits, liabilities, income sources, assets, expenses and revenues etc.
- external sources of information – specialised service agencies, newspapers, magazines etc.

Under the National Bank of Romania's regulation[6] the principal and credit are defined as follows:

[6] Regulation No. 2/2000 concerning the classification of credits and placements, issued in Monitorul Oficial al României No. 316/2000

a) *The principal* represents the amounts advanced by the bank to the debtors in the form of loaned capital, including also in this category when becomes due the banks' obligations resulting from agreements to lend and to provide guarantees, as well as deposits placed at other banks;

b) *Credits* – The credit categories shall be classified depending on debt service and initiation of legal proceedings (e.g. credits granted to clients from the non-banking sector, credits granted to banks, credits granted to clients of the non-banking sector etc.).

Before granting a credit/loan, a bank makes a ***trustworthiness analysis*** of the customers.

*The main trustworthiness ratios are:*

| | |
|---|---|
| *Indebtedness level* | $\frac{\text{Total liabilities}}{\text{total assets}} \times 100$ |
| *Immediate Liquidity* | $\frac{\text{Current asset}}{\text{short term liabilities}} \times 100$ |
| *Solvency Ratio* | $\frac{\text{Owners' equity}}{\text{owners' equity + liabilities}} \times 100$ |
| *Profit margin* | $\frac{\text{net profit}}{\text{turnover}} \times 100$ |
| *Coverage of expenses with revenues* | $\frac{\text{Total revenues}}{\text{total expenses}} \times 100$ |

The main principles of granting credits are:

- The banking prudence;
- The creditworthiness of the borrowers;
- The credits granted should be profitable both for the bank and for the borrowers;

- The credits have a destination precise and mandatory which can not be changed by the borrowers;
- Credits are granted under guarantees that are written the credit contract. The guarantees must cover the maximum amount of credit, amount consisting in the principal and interest.
- The bank shall reserve the right to verify to its customers (borrowers) the permanent existence and the integrity of the ensured guarantees during the whole period of the credit. In the case in which the bank shall establish the non-observance of the contractual terms, it shall withdraw the credits before the maturity date;
- During the validity of the credit, the beneficiaries of the credits have the obligation to deposit to the bank their balance sheet and the financial statement;
- Under the provisions of the banking law, the loans granted to a single debtor, shall not exceed 20% of the capital and reserves of the bank. In order to receive the credit, the economic agents should accomplish the following conditions:
  - to be recorded as a company, under the provisions of the law;
  - to have the capital paid off;
  - to carry out legal and efficient activities;
  - to have good indicators; to have opportunities to re-imbursement at maturity both the credits and interests;
  - to possess moral and materiel guarantees;
  - to agree the contractual terms etc.

## 9.5 Working capital analysis and financial projections

Historically, the major role of banks in commercial lending has been to finance non-permanent additions to working capital, defined simply as all current assets. Such additions enable the business to increase its cash balances and inventory in anticipation of seasonal bulges in sales and temporarily to extend larger amounts of credit to its customers as an after-effect of such sales. Working capital loans are said to be self-liquidating because repayment occurs with an orderly reduction in inventories as sales rise, followed by reductions in receivables after collections are made on

credit sales. The repayment of such loans is largely independent of long-term profitability and long-term cash flows.
The measure known as net working capital, defined as current assets minus current liabilities, indicates the amount of a firm's working capital that is financed by long-term or so-called permanent sources of funds. Net working capital is a good indicator of a firm's liquidity because it identifies the part of a firm's most liquid assets that is supported by reliable (long-term) funds; that is, it is the amount of current assets that is not subject to claims by holders of current liabilities.

A corollary measure of liquidity is net liquid assets, which is a rough indication of the absolute currency amount of liquidity in the firm. Subtracting from current assets the amount invested in inventory and all current liabilities derives it. Inventory is subtracted because its liquidity is often suspected.

***Sources and uses of funds analysis* – decreases in assets and increase in liabilities constitute sources of funds, whereas increases in assets and decreases in liabilities are uses o funds. It can be used to make simple financial projections.**

**More detailed projections are probably warranted in the form of *cash budgets*. The preparation of cash budgets requires projecting specific cash inflows and cash disbursements on a monthly or even more frequent basis. The cash budget more closely identifies the amounts and timing of specific draws against a credit line extended by a bank, or, alternatively, it identifies periods of excess cash in which short-term money market investments can be considered.**

In the final analysis of a loan, lenders must rely upon cash flow to repay loans. Cash flow from a firm's operations, although not directly available, can be derived through adjustments to the firm's balance sheet and income statement.

Thus, it should be mentioned that the borrower's ability to repay a loan is mostly a matter of financial analysis. Historical financial analysis is two-dimensional. Time series analysis is used to spot evolving financial strengths and weaknesses with the perspective of the passage of time. Cross-sectional analysis permits the analyst to determine how effectively the borrower has performed in relation to other firms with like market opportunities and risks.

Under the provisions of the Law No 58 – the Banking law, the credit documents needed for the conclusion of the convention between the bank and a potential client (see Annex No. 2) are the following:

- Application form (see the Annex No. 1);
- Current financial situation of the applicant and of any of its guarantors, including the projected cash flows for the repayment of credit and principals;
- Description of the guarantees for the entire payment of the debt, and if necessary an analysis of the goods representing the guarantee;
- Description of the credit conditions containing the credit value, the interest rate, the repayment procedure, the scope for using the credit;
- Specimen of signature for each person that authorised the credit and the name of the bank;
- Annual Balance Sheet and Profit and Loss Account for the last three years of operation (plus annexes);
- Company's Overview;
- Description of the current activity/ financial info;
- The cash-flow statement for the entire loan period;
- Description of the credit conditions containing the credit value, the interest rate, the repayment procedure, the scope for using the credit;
- Specimen of signature of each person that authorised the credit and the name of the bank.

## Progress Test

1. What is the meaning of loan?
2. What are the sources of funds used by the Romanian banks?
3. List and comment the five stages of the analysis of a new lending proposition.
4. List and comment 5 types of loans.
5. What are personal loans?
6. What is the revolving credit?
7. List all the types of loans classified by maturity, destination and pricing.
8. Describe lending money.
9. List the main ratios calculated by a bank in order to establish the trustworthiness.
10. List the elements of the application form.
11. List the main documents submitted by a customer to a bank in order to receive a loan.

**ANNEX No 1**

## CREDIT REQUEST

Company: "X" SRL
Represented by: Mr. X (authorised to sign)

WE REQUEST the following facility:

- Overdraft
- ➢ Loan
- Line for L/Gs, L/Cs

In amount of: ___135,000_______Currency___ USD_ Multicurrency __

Object of facility: purchase of 400 sqm piece of land

Validity: from 31/08/00 to 30/11/00

Reimbursement:

- at the end of the validity period
- ➢ Several instalments

Securities proposed:

- ➢ Cash collateral ________________________________
- Letter of guarantee ________________________________
- Mortgage on land/buildings ________________________________
- Assignment of receivables ________________________________
- Pledge business assets/shares ________________________________

Please find attached the necessary documents for each type of security. The bank has the right to choose the securities for the credit facility.

**ANNEX No 2**

## LOAN AGREEMENT NO… /31.07.200_

**The Romanian Bank… S.A.** registered in the Register of Trade under no… Branch… hereby called "the bank", represented by L. C. as general manager, and

**The company "X" SRL**, registered in the Register of Trade under no…………hereby called "the borrower", represented by Mr. Y, as general manager, has agreed upon the following:

1. The bank grants the borrower a loan amounting USD 135,000, for 90 days, with an annual interest rate of 9.5%, in order to pay for a piece of land of 400 sqm, located in Bucharest.
2. The loan is granted through the account no…………….
3. Payment settlement is money transfer, as a general rule for all instalments, the possible cash payments being approved in the long run as the necessities require.
4. The loan is granted on a temporary basis, until stocks are constituted and expenses recorded, by direct discount of payment documents, in conformity with the approval ceilings the bank disposes of at the time.
5. During loan employment and collection, the bank is allowed to adjust the interest rate in accordance with the evolution of inflation and cost of financial resources. The new interest rate is to be applied to the loan balance of the date of changing. The borrower is to be informed within 5 days, in writing, with no other specification. In case that, after being notified, the borrower does not pay the rest of the principal and interest within less than 10 days since notification, the bank is entitled to consider the new interest level as accepted and payment of the newly computed amount (rest of principal and interest) as granted, with no other specifications.
6. The interest and fees for the loan granted are computed and paid monthly, beginning with a month after the loan is granted; cashing being performed directly by the bank, out of the borrowers direct account, based on statement of account. Interest computation period is since the 21$^{st}$ of the last month till the 20$^{th}$ of the current month.

Computed interests that could not be cashed by the end of the month (on the last working day of the month) are to be recorded in the account "Uncollected interest till 30 days". In case that these amounts cannot be cashed due to lack of cash of the borrower, they are to be transferred from the above-mentioned account to "Uncollected interest longer than 30 days" account. These amounts will be adjusted with a rate of 0.4 for every day of delay taking care that penalties will not amount more than the initial amount due.

7. Dates and amounts to be collected:

| DATE | PRINCIPAL | INTEREST | TOTAL AMOUNT |
|---|---|---|---|
| August, 30, 2000 | 45,000 | 1,068.75 | 46,068,75 |
| September, 30, 2000 | 45,000 | 712.5 | 45,712.5 |
| October, 30, 2000 | 45,000 | 356.25 | 45,356.25 |
| **TOTAL** | **135,000** | **2,137.5** | **137,137.5** |

8. The loan (principal and interest) is allowed to be pre-paid, partially or entirely.

Any breach of the clauses of the present contract entitles the bank to cancel the loan, unconditionally, and to get payment from the borrower for the possible damages.

In case that within 30 days since the date the bank is informed about the borrower's inability to pay the due amounts of principal and interest, the borrower is still not able to pay these amounts plus penalties, the whole principal and interest become eligible and the bank will proceed to liquidate, according to law, the guarantees, to cover the loss.

9. The borrower is committed to secure the loan concluding a collateral contract with the bank, specifying hereby the precise characteristics of pledged goods. According to the contract, the pledged goods remain in the borrower's possession, with a preferential claim of the bank in case of the borrower's default.

10. The bank has the right to check observance of the terms by which permanent availability and integrity of the pledged goods are insured, during the entire life of the loan.

11. Alteration, degradation, improper maintenance or use of the pledged goods, as well as legal ascertainment of changes in their value, entitles the bank to cancel the unsecured loan before stated maturity.
12. The borrower is committed to:
    - employ the loan only for the specified destination;
    - pay the principal, interest and fees on their agreed upon maturities;
    - observe bank's regulation and to properly record all transactions concerning granting, employing and collecting the loan;
    - submit its Balance Sheet to the bank;
    - submit, on bank's request, all documents – revenues and expenses budget, Income Statement, as well as all documents concerning guarantees, goods or process employing borrowed money.
13. The bank is entitled to cancel the loan in case the borrower submits unreal data, beginning collection 5 days after notifying the borrower in writing.
14. The bank does not take political or natural disaster risks and is not responsible of the legal value (authenticity) of submitted documents.
15. Mutual bonds that are not specified in the present contract must observe credit rules as well as all banks' regulation in force at the moment.
16. The borrower must declare other loan agreements with other banks, in force at present, together with the collateral backing up these loans.
17. Any litigation between the hereby-stated parts is to be solved in the Court.
18. The present contract has legal force and power of executor title.
19. The contract is concluded, today, July 31, 2000, in 4 copies, 3 remaining with the bank and one with the borrower.

The Romanian… Bank SA
**General Manager,**

**L. C**

The Company "X" SRL
**General Manager,**

**X**