

Practical Constraints on Collaterals under Iranian Law

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The different forms of collateral usually accepted by the banks in Iran are: bank guarantees, immovable property, movable property (particularly machinery, equipments etc.), bonds, warehouse receipts and personal guarantees such as promissory notes. Later on we shall see that due to the certain legal requirements, the intangible properties do not serve as reliable collateral under Iranian Law.

A. Immovable property:

The banking institutions in Iran are accustomed to rely on immovable property as the main acceptable collateral. For this reason, bank seek for an unencumbered deed to the property offered as a collateral. To this end, banks will have to verify the following points before taking a mortgage on immovable property.

1. The deed is duly registered.
2. The borrower holds a clean title on a legally divided and registered property.
3. No previous mortgage, lien or other encumbrances, whatsoever has been established on the property. Moreover in case of Agricultural Lands:
 1. The Ministry of Cooperatives and Rural Affairs has certified that

the mortgage and eventual sale of the property is not against the Land Reform Laws and Regulations.

2. The Ministry of Agriculture and Natural Resources has certified that, under the relevant Laws and regulations, the land is not considered a forest and will not be considered as such in the future.

3. The Ministry of water and Power has certified that the water resources available to the project may properly be used for the purpose of irrigation, under the relevant Laws and regulations.

4. The bank, then will have to compare the different permits and certifications so that there may not be any inconsistency among them.

Under the Iranian Law a mortgage on immovable property will have to be registered. Miscellaneous fees and charges amounting to 12 and 1/4 per mill in case of the duly registered properties and an extra charge of 55 per mill in case of the clean deeds not yet officially registered, increase administrative cost of the loan, as well.

B. Movable property:

Any existing movable property may effectively be subject to mortgage under Iranian Law. The problem, however, is that the mortgagee should hold possession of the property. For this reason, in order to establish an effective lien on this kind of property, the mortgage agreement should be notarized which means that all movable property such as machinery, equipments, tools and even animals should be clearly identified and registered in details. Thus, the procedure is time consuming and impractical. Moreover, any time the borrower decides to change an equipment or even sell the animals, he will have to obtain approval of the lender and the replacements will have to be registered as well.

A warehouse receipt (under relevant Laws and Regulations) may be

used to mitigate some of the problems arising out of the mortgage of movable properties. However, due to several factors such as the cost of storage and transportation of goods and also inconvenient location of warehouses, the use of warehouse receipt as a collateral has been limited. It should be noted that loans made on warehouse receipts are usually short term loans and can only provide the producer with some of his post harvest financial needs. Therefore, for long term credit requirement, other collaterals will still be needed, as the warehouse receipt is not an appropriate collateral for a long term credit.

C. Other valuable assets:

Under the Iranian Law (civil code and Registration Acts) a mortgage lien may only be charged on physically existing properties. This means that other assets of borrower such as accounts receivable, crops on hand and other similar products, machinery on order and even borrower's right under long term lease cannot be considered as a suitable collateral for banks.

This situation has created problems specially for investment banks. Some private banks, for their own protection, sometimes require the borrower to furnish post dated or undated cheques and promissory notes. The commercial banks uniformly resort to this device because of the legal sanctions which exist for the issue of cheques without provision, under Iranian Law.

D. Problems of foreclosure:

Under the Iranian Registration Act (before the recent amendments in 1973) the legislator, for the purpose of maintaining the liquidity of the banks, made an exception in favor of the banking institutions. The exception was that, although after foreclosure the mortgaged property would legally be transferred to the creditor (against his outstanding credit and charges

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thereto), the banking institutions were exempted from this general set of rule, i.e., in case of a deficiency if the foreclosure did not fully meet their claim, the banks could still refer to the borrower for the balance of their credit. Some commercial banks, unfortunately misused this privilege and consequently, under recent amendments to the Registration Act, the banks forfeit their privilege. Apart from this, the recent amendment poses other constraints on investment banking business in Iran. Some of the disadvantages of the amendment to the banks are as follows:

1. In case of the transfer of the title of the mortgaged property the creditor must reimburse the borrower with what sums the borrower has paid previous to the foreclosure on the account of his indebtedness. The Government, the Government agencies and the Government corporations and the banks are, however bound to reimburse only what they have received on account of the principal amount of the credit.

2. The rate of interest ordinarily charged by an investment bank is less than 12% per annum. Before the recent amendments, the borrower was liable to pay a penalty of 12% as deferred payment losses, upon the issuance of the execution order. This high rate of interest, in most cases, dissuaded the borrower from default. The recent amendments, however, provide that the contractual rate of interest is also applicable for deferred payment losses.

3. The second mortgage procedure formerly recognized under the repeated Article 34 of registration Act is now practically abolished by recent amendments. This would mean that once the borrower has established a mortgage lien on a property in favor of a lender he may not establish a second mortgage lien on the same property in favor of another lender.

E. Government Bank and the problem of collateral.

The Government sponsored bank, such as the Agricultural Development Bank of Iran and the Industrial credit Bank of Iran are also authorized to grant loans, and credit to private enterprises. Of course, government institutions and development authorities such as the Regional Water and Power Corporations should apply for credit to the Central Bank of Iran. There is, however, an obvious distinction between the kind of collateral acceptable to the Central Bank of Iran and those acceptable to the government banks, such as Bank Melli Iran or Agricultural Development Bank of Iran. The Central Bank of Iran by virtue of its statutory powers has established a very liberal attitude towards the problem of collateral. Due to the fact that the Central Bank of Iran is not a commercially operated bank and its credit facilities are only available to the public sector, therefore, the question of collateral is of less importance. Thus, the customers of the Central Bank are in a better position. On the other hand a government bank, such as Agricultural Development Bank of Iran, which provides credit facilities to the private sector is deemed to follow a more rigid policy towards the problem of collateral requirement. In other words a government bank is the trustee of the government funds and before granting credit to the private sector it should make sure that the government funds will be duly repaid. Thus the government banks are, now, in awkward situation. They have to rigidly abide by the provisions of Law and to compete with private banks, as well. The private banks enjoy a wide discretionary power regarding the acceptance of collaterals and, therefore, they sometimes protect themselves by accepting personal guarantees and commercial papers as complementary security, whereas the government banks will have to rely mainly on effective mortgage, especially for granting long term credits.

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The brief survey presented in this report highlights some of the problems of collateral requirement under the present Laws and Regulations and also indicates the need for a revision of the existing body of laws relating to the investment banks collateral requirements with due consideration to the recent progress in the structure of Iranian Economy. Despite the disadvantages resulting from the recent amendments to the registration Act, in the long run, the new law will certainly change the banker's attitude of relying too much on immovable property. No doubt credit system will expand in the future, but a whole new set of laws should be enacted introducing an efficient system of mortgage and lien, not only applicable to the existing properties, but also regulating the establishment of a lien on the future assets of the borrower. The idea of drafting a commercial mortgage law is now being elaborated by responsible agencies of Iranian Government. Due to the fact that establishing a lien on future acquired properties and accounts receivable is a radical change of Iranian classic system of mortgage, one may not reasonably expect such a law to be ratified without prolonged discussions and elaborate studies.