

ASSURANCE MEASURES AND THE RELATIONSHIP BETWEEN LOAN CONTRACT AND SECURITY AGREEMENT IN CREDIT ACTIVITY OF BANKS

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ABSTRACT:

This paper provided a general overview of security measures and the interactions of loan contract and security agreement in the credit activities of banks. Additionally, this paper also pointed out some typical examples and remarks about them to explain related regulations.

Keywords: law, loan contract, security agreement, credit activity.

1. Introduction

For a long time, the legal system of Vietnam has been regulating the types of security for the performance of obligations in loan contracts. Furthermore, nowadays, these regulations are increasingly becoming more complete than before. The measures were undertaken based on many elements, including checking the extent and effectiveness of loans, among others. The article supplies some legal issues about guarantee measures, the relationship between loan contract and security agreement, and the author also points out some typical examples and remarks about them to analyse and explain for regulations.

2. The security measures for loans in the banking sector

According to the Civil Code 2015, there are nine types of security for the performance of

obligations; however, in the activities of banks, usually not all methods are undertaken, and credit institutions typically arrange these measures into two types: loan security by prestige and loan security by property.

2.1. Loan security by prestige

The regulation about prestige lending became law in the banking sector, but nowadays, it does not have rules about the practical process, including legal responsibilities arising with credit organizations. The law allows credit institutions to organize and undertake based on effective principles, but it also pushes risks onto decision-makers.

Obviously, this measure will create convenience for borrowers, and the bank does not need to focus on the property of the customer. Certainly, it is very risky in instances where the

customer loses their funds and solvency. For example, banks may not be able to recover the loan amount. With these restrictions, the law needs to build a legal policy about prestige lending instead of ignoring and not being interested in the consequences, such as difficulties in the operations of credit organizations, or even being prosecuted for criminal liability.

In our opinion, the lawmakers need to provide allowable conditions for prestige lending, solutions for contract violations, and clarity on the responsibilities of credit institutions to avoid anxiety in lending.

2.2. Loan security by property

We can say that it is a popular method in the credit activities of banks. The most commonly used measure for banks is the measure of accepting accepted assets. The regulations on mortgage measures have almost been completed, but in this measure the biggest difficulty is identifying collateral. Normally, the bank divides property into two types: immovable property and movable property. The Civil Code 2015 states that immovable property includes: land; houses and constructions attached to land; other property attached to land, houses, and constructions; other property as prescribed by law; while movable property is property that is not immovable property.

Real estate (for example: land, buildings, houses, etc.) is an asset that can be easily managed and valued, but its prices always fluctuate, making it especially difficult to handle as collateral. Meanwhile, movable property (for instance: cars, motorcycles, airplanes, ships, etc.) is extremely difficult to control because it is easy to transfer ownership and carries significant risk of damage such as burning, explosion, or accidents. In fact, most credit organizations prefer to accept immovable property over movable property.

Additionally, collateral assets include property rights such as the right to collect debts, receivables, the right to request payment, or property rights formed in the future, which are also approved by

law to lend. However, legal regulations on how to handle these assets are not clear, so very few banks like this type of asset.

Another approach, some international banks arrange collateral to become two types. The first is called inside collateral, in which the borrower uses an asset in the project to be financed as collateral; if there is a default, the lender takes possession of the project. The second type is called outside collateral: assets not used in the project are posted as collateral.

In conclusion, although the law has many assets that can become collateral, with their risk appetite, banks are often very careful when choosing the types of assets to receive collateral. One of those important barriers is unclear legal regulations.

3. The legal relationship between loan contract and security agreement

Obviously, it is important to understand that security agreement is a portion of the loan contract. Therefore, the terms of security must be mentioned in the content of the loan contract or be designed to become a separate contract. Both contracts must show a close relationship about the legal side.

According to Article 29 of Decree No.21/2021/ND-CP states:

“1. Security agreements that are nullified, annulled or unilaterally terminated shall not terminate contracts with secured obligations.

2. In case contracts with secured obligations are nullified, annulled or terminated, proceed as follows:

a) terminate security agreements in case parties have not executed contracts with secured obligations;

b) do not terminate security agreements when parties have executed parts or all of contracts with secured obligations. Secured parties have the right to realize collateral to pay for repayment obligations with parties which they have obligations to.”

This regulation clearly explains the legal relationship between the loan contract and the security agreement. Specifically:

Firstly, the laws assert the independent nature of security measures for the performance of obligations, which are based on the legal form of the security agreement. Some scientific researchers, including myself, view the relationship between these two types of contracts as that of a main contract and a subsidiary contract, because based on the codified obligations of the contracts, the security agreement can be considered a subsidiary contract to the loan contract. Nevertheless, unlike the typical relationship between a main contract and a subsidiary contract, if the loan contract is deemed invalid, the security agreement remains independent and valid.

For example: Company A applied for a loan of 1 million USD from SB Bank to restructure its loans. The collateral is a housing development project in Ho Chi Minh City. According to the bank's internal regulations, before signing a loan contract, SB Bank - Ho Chi Minh City branch must appraise the collateral and submit it to SB Bank's Credit Committee for approval. And after the loan contract is signed, the bank can disburse the loan to the customer.

However, due to subjectivity, SB Bank - Ho Chi Minh City branch did not wait for the approval results from the bank's Credit Committee but immediately signed the contract and disbursed the loan.

The incident was discovered when company A failed to fulfill its payment obligations and the bank sued to request settlement.

After reviewing the entire case file, the court found that although the loan contract between the bank and Company A was determined to be invalid because the contracting entity exceeded its authorized powers (i.e., the authority of the Branch Manager to sign loan contracts is only valid when approved by the Credit Committee). However, in practice, the bank had disbursed funds to Company A, and the authorization content does not limit the authority of the HCM

Branch Director to sign security agreements. Therefore, based on Article 405 of the Civil Code 2015 and Article 29 of Decree No.21/2021/ND-CP, it is decided to allow SB Bank to handle the collateral to recover the loan.

Obviously, although the relationship between the loan and the security agreement has the same nature as that of a main contract and a sub-contract, unlike other transactions where the invalidity of the main contract leads to the invalidity of the sub-contract, here even though the loan contract is invalid, the security agreement is still recognized. This shows that the nature of the borrowing relationship requires full repayment and ensures that the lender, the bank, is able to recover the loan.

Secondly, the invalidity of security trading does not lead to the invalidity of the loan contract. The legal system of Vietnam clearly regulates the conditions of guarantee properties and the content of security agreements. For example, in the case of asset mortgage measures: the mortgaged property must belong to the ownership of the mortgagor; the mortgaged property can be described in general terms, but it must be located; the property must be visible or formed in the future; the value of the guarantee property can be higher, equal to, or lower than the secured obligations. However, in practice, there are still many contentious instances related to security measures, including the invalidity of security agreements. Although this issue does not affect the validity of the loan contract, it does significantly impact the handling of guarantee property.

For example: A Joint Stock Company borrowed capital from VB Bank under Credit Contract No. 111 dated 16/07/2011. As of 2/3/2020, the total debt obligation of the Company was 4,651,530,209 VND (including principal debt, interest bearing debt, and overdue interest), classified as Group five debt.

The collateral for the loan consists of four properties, of which three properties do not have any

issues requiring advice (hence, they are not mentioned), and one property has an issue:

- Collateral has an issue: 154 square meters of residential land in village X, commune Y, Chuong My district, Ha Tay province (now Ha Noi city) according to the land use rights certificate No. U455103 issued by the People's Committee of Chuong My district, Ha Tay province on 21/06/2002 to the family of Mr. Trinh Van C.

- The mortgage contract was signed by Mr. Trinh Van C and his wife Mrs. Nguyen Thi B with VB Bank, notarized on 14/07/2011, and registered on 15/07/2011.

- At the time of signing the mortgage contract, the family residence book of Mr. Trinh Van C listed the following members: Trinh Van C (born in 1969, head of household); Nguyen Thi B (born in 1975, wife of Trinh Van C); Trinh Van H (born on 18/08/1995, child); Trinh Thi H (born on 10/01/1998, child).

VB Bank filed a lawsuit requesting Company A to repay the total debt amount (including principal and interest), and allowing VB Bank to handle the collateral to recover the loan in case Company A fails to fulfill its obligations. The Primary Court issued a judgment decision:

- Partially accepting VB Bank's lawsuit request, thereby requiring Company A to repay the total debt amount (including principal and interest);

- Allowing VB Bank to handle the three remaining collateral properties and declaring the mortgage contract related to the land use rights certificate No. U455103 to be invalid due to violations of Articles 109 and 208 of the 2005 Civil Code.

VB Bank appealed, and the Appellate Court decided: To amend part of the primary judgment by declaring the mortgage contract related to the land use rights certificate No. U455103 to be partially invalid of Trinh Van H based on the provisions in Clause 2 Article 109 of the 2005 Civil Code, Clause 2 Article 146 of Decree No.181/2004/ND-CP, Article 15 of the Land Law 2003, Articles 135, 216,

Clause 1 Article 223 of the Civil Code 2005, and Article 212 of the Civil Code 2015.

From this example, we can see that when the Court trials credit contract conflict cases, it also examines related issues such as security agreements. In addition, even if the security agreement is declared completely or partially invalid, the loan obligation is always recorded and is not affected based on the loan contract. However, in these instances, the banks will face difficulties in recovering the loan amount if they were careless in evaluating the security property, because a fraction of the security property had been invalidated.

Finally, we can be certain that the legal relationship between a loan contract and a security agreement is extremely profound. The security agreement can be considered a subsidiary contract to the loan contract, and it helps credit institutions avoid risks in instances where the customer loses their funds and solvency. Additionally, it allows banks to recover the loan amount by utilizing the security property solutions.

4. Conclusion

The relationship between security agreements and loan contracts is built on the principle of safety, ensuring the rights of credit institutions. The maintenance of the regulation that an invalid loan contract does not affect the validity of the security agreement also aims to protect these rights. However, due to the diversity of lending methods, extended time periods, and the complexity of collateral, ensuring the legal connection and binding between these contracts has not yet been thoroughly addressed in practical law. Violations in the application of the law frequently occur, causing significant damage to credit institutions and creating anxiety among credit officers and staff who are liable for losses. This paper aims to clarify the legal provisions concerning the relationship between loan contracts and security agreements to help individuals and organizations implement and apply the law effectively and accurately ■

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TÓM TẮT:

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Từ khoá: pháp luật, hợp đồng vay vốn, hợp đồng bảo đảm, hoạt động tín dụng.