

Study of Collection of Bank Receivables in the Commercial Code and New Bill of Commercial Code of Iran

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***Abstract---** According to Article 2 of Commercial Code of Iran, banking activity is a kind of commercial transaction; therefore, banks are considered as merchants subject to applicable rules on this group. Increasing rates of overdue and deferred receivables of banks relative to total current loans in banking system are new national challenges in Iran due to bankruptcy and existing legal gap. The legal gap in this field is an extra reason that increases overdue and deferred receivables in banking system. This reason is categorized into three main groups of banks, debtors, and external factors. Therefore, it is essential to investigate the issue and its solution in order to prevent increasing outstanding claims of granted loans and collection of debts. If the abovementioned problems are solved, banking system and browsers will benefit from a suitable situation. On the other hand, there are debtors who are not able to repay loans or do not tend to pay their debts despite their financial power. In case of external factors, some crises such as domestic and international issues, the government, courts, registration rules, notary offices, and the like have doubled complexity of mutual interaction between bank and debtor. Therefore, this study examines the structure of banks, bank's debt collection, measures taken by banks to prevent consequences of bankruptcy, and private-specialized debt collection agencies.*

***Keywords---** Outstanding Claims of Banks, Collection of Banks' Receivables, Prevention of Bankruptcy Consequences*

I. INTRODUCTION

Increasing rate of past dues and outstanding claims (deferred receivables) and subsequent decreasing liquidity of banks can be named as the most crucial problems in banking system. These problems in turn lead to disruption in allocation and of resources and recreation of resource cycles, decline in bank revenue and interest, lack of investment of such banks and institutes in projects, and disruption in economy of countries especially banking system-based countries.

Because banks collect resources and manage a main part of liquidity of society, they play a vital role in economic system and adjustment of financial-economic relations. Hence, rising outstanding debts and similar cases causes accumulation of bank reserves and this makes bank managers, economists, and lawyers to investigate and study the problem to find coping strategies. Pathology of this issue and reasons for increased deferred receivables can be done as the first effective measure. However, practical solutions within a continuous and flexible way regarding progressive trade world of today can alleviate adverse effects if such debts on the banking system. In doing this, the problematic financial situation of bank will be reformed and improved. In fact, the more considerable past due and overdue (or outstanding) debts such as bad debts are the main issues causing diversity and dispersion of debts that worth not to spent cost and time

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to collect them for bank or financial institutes. In some cases, these debts and credits are not repaid even after performing legal and judicial formalities and measures.

Obviously, such debts and claims have negative and inhibitory effects on resources-expenses cycle of banks and financial institutes. Any type of debts reduces the liquidity cycle of economy either in terms of domestic and retail viewpoint (including operating costs, revenues or profitability, bank branches' tanks and promotions, and other qualitative-quantitative indicators) or in terms of international and external perspective (considering the activities of these banks and financial institutes compared to international banks and new rules and regulations). The outstanding claims of banks cause lack of resources assignment and redistribution in manufacturing and industrial projects at due time, lack of employment, economic recession, and increased overdue receivables in banks. Such concerns influence the banking system activities. Hence, this study was conducted to analyze bank debts collection in perspective of Commercial Code (C.C) and New Bill of Commercial Code of Iran (N.B.C.C).

II. BANKING STRUCTURE OF IRAN

Bank is an economic institute that mobilizes resources, distributes and grants credits, performs credit and financial operations, buys and sells different kinds of currencies, transfers funds, pays customer dividends, accepts deposits, keeps securities and bonds and precious objects, executes guardianship and administratorship for customers, and represents advocacy for purchases and sales.

Other financial institutes that are legally different with bank are called non-bank credit institutions. Banks are subsets of financial service industry. According to paragraph 3 of Article 1 of regulations on how establish and manage banks approved on 2 November 2009 by Money and Credit Council (MCC), the most important function of bank is intermediary between money suppliers and applicants.

Capital flow between households and firms through banks provide a proper field for investment financing in the economy. Banks provide depositors with low-risk savings deposit services and convert their deposits to loans or other high-risk assets of investment firms with determined or agreed interest rates and efficiency. Banks change the risks of the abovementioned capitals to investment opportunities and grant them as new packages to competent economic agents by relying on their perfect management and diverse resources and customers.

Enforcement of Monetary Policy of Banks

Monetary policy includes some measures employed by monetary officials or central bank to control economic activities of society (Monetary and Banking Research Institutes, 2001). Because lack of adjustment between liquidity volume, and goods and services cause recession of inflation besides other economic and social problems, liquidity volume adjustment is highly necessary (Komeijani, 1993). Therefore, money supply and demand should be controlled and managed systematically and purposefully regarding interest rate changes to avoid adverse effects of excessive rise in liquidity and recession caused by liquidity shortage (Mojtahed & Hassanzadeh, 2008).

Central banks make some changes in monetary base, money multiplier, volume of money, and hence economic variables by using quantitative and qualitative tools to achieve predetermined goals (Moosavian, 2007).

According to banking rules and regulations of every country, depository banks and institutions are responsible to give a percentage of demand and term deposits as RRs (reserve ratios) to the central bank. This tool is used as one of important Leverages of monetary policy implementation that controls the volume of credit loans by guaranteeing security of deposits and changing the mentioned indicators. These indicators are associated with financial intermediary of banks and the abovementioned tool can repay the acquired resources, to keep funds, and to control the effect of rapid change in RR on the volume of credits granted to private sector by banking system (Komeijani, 1993).

Banks' Debts Collection

Receivables include any granted loan or debt that should be repaid. Collection of debts is defined as settlement of debit or credit accounts. The debt or loan may be in form of cash, post-dated check, goods, etc.

Five steps have been designed to achieve objectives of granting facilities and timely collection of debts:

- Assessing competence and credibility of applicants;
- Examining justification of granting loans and the associated risk;
- Precise and constant monitoring over the contract enforcement;
- Insuring the projected facilities or properties under the contract as well as collaterals and guarantees;
- Receiving sound collateral and guarantee

The executive and judicial measures of relying on mortgage deed, loan allocation document, and internal bank contract, note payable on demand, and certified cheque or check should be taken to collect the abovementioned receivables. Each measure is done based on a different executive and judicial methods and steps that are not the subject of this paper.

Banks can avoid the increase in outstanding or overdue claims by applying four components. Five Cs (Capital, Character, Capacity, Collateral or refund guarantee coverage, and Conditions) play a vital role in identifying customers who demand for loans. There are two kinds of threats and harms against banking system including bank failure and wrong decisions made in field of monetary policies that threat lifecycle of banks. The outstanding claims are caused by mandatory facilities imposed on banking system by the government, which in turn causes following drawbacks:

- Reduction in available sources of banks;
- Disturbance in employment and production process;
- Depravity and inability of small industries, quick-impact projects and economic firms to obtain loans;
- Inability of banks to provide services and facilities for reputable customers;
- Paying much more administrative costs by banks to collect debts
- Lack of financial capacity of banks to provide new services and facilities and blocking financial sources of banks in hand of a specific social class;
- Negative effect on the competition between economic actors due to lack of sound atmosphere.

Barriers to receivables collection and subsequent consequences

There are two categories of factors influencing formation and development such issue. First, economic conditions ruling the society such as inflation that motivates non-repayment and second, banks' performance that encourages and actualizes this incentive. Banks' performances may cause a rise in outstanding claims due to following shortcomings:

- 1- Lack of an integrated online validation and ranking customers' credits for all of banks and financial institutions;
- 2- Lack of a comprehensive and new database of loan applicants;
- 3- Lack of enough information of banks about loan applicants and lack of transparency in business and professional activities, and lack of clear information system;
- 4- Lack of implementing terms required for granting loans by banking system considering Circulars approved by Central Bank and internal documents of the banks, and lack of supervision and punitive factors performed by central bank.

Effect of bankruptcy on banking system

Because there is not any record of bankrupt merchants, banks grant loans to such individuals who pledge fake documents or even seemingly real tax clearance certifications. In this case, debtor does not incur his/her obligations then

bank investigates debt collection cases associated with bankruptcy of merchant or business enterprise and discovers the date of bankruptcy, which goes back to the time before granting loans.

The abovementioned cases create serious challenges for banks such as decreased profitability and increased credit risk owing to deposition of financial sources and risk of bankruptcy. Bankrupt debtors of banks' receivables usually file a petition for bankruptcy with judicial bodies without introducing the creditor banks also without presenting clearance certification, balance sheet or business books. This action is obviously a formal and unreal practice.

There is increasing number of bankrupt debtors of banks and prolonged investigation of liquidation cases by bankruptcy courts, observer member, and or settlement agent as well as numerous legal problems of banks in collecting their debts. Hence, central banks, bankruptcy courts, and other regulatory and judicial authorities are allowed to take some measures in creating a comprehensive notification and operating system for banking affairs. Accordingly, the involved banks in bankruptcy and non-involved ones (banks that grant loans and credits) can be aware of bankruptcy petitions filed by merchants and business companies. In doing this, banks can administer justice and prevent infringement or third part objection under the order issued by prosecutor, Deputy of Public Prosecutor, and central bank. Accordingly, specific branches can investigate the bankruptcy and liquidation cases in favor of banks.

Measures taken by banks to avoid consequences of bankruptcy

1. Administrative and Incentive Measures

Pursuant to Paragraph (a) of Articles 11 of Monetary and Banking Law of Iran Approved on July 1972, central bank is responsible for supervision of banks and credit institutions regarding license issuance and controlling bank's operations. Banks' operations are controlled to avoid excessive financial liabilities of banks, to mitigate enforcement agents required for collecting debts, and to make balance between receivables. As a regulatory tool, Capital Adequacy Ratio (CAR) that is the ratio of core capital of bank to sum of percentage of risk-weighted assets. If this ratio does not work, regulatory institutes such as central bank will take required measures to prevent bankruptcy of bank.

1-1. Validation

As mentioned, it is essential to validate customers before granting credits or loans. Heretofore, this validation was judged by making a close relationship with creditors (financial institutions and banks) so applicants could mask their financial history. The overdue debts and claims of banks led to loss of banks and financial institutions; hence, they designed linear and non-linear audit analytical statistical patterns for natural and legal persons. Nevertheless, some demands given by clients are not accepted due to high risk of client based on the ranking system of bank. In such cases, the rejected request is modified by credit experts of banks within a mutual process in which, the type of loan is changed, the amount of loan or credit is reduced, and the due date of repayment is mitigated to alleviate the possible risk.

1-2. Reducing the gap between liquidity and resilience

In contrary to merchants whose assets are composed of objective assets, the main part of banks' assets is in form of private properties or receivables. The receivables can be transacted or converted to cash based on the current situation. In fact, the receivables are collected considering the terms of the case, documents, guarantees and record acquired by banks. Moreover, liquidity risk of deposits may create problem for banks under the influence of community, customs, and the like.

1-3. Reforming the administrative structure

The most crucial factors that cause delayed repayment of bank loans include obligation breach (fault)-raised non-payment, non-payment without fault, non-payment due to bad intention and fraud that are rooted in conditions of the community and market.

Sometimes, the client benefits from delayed repayment due to economic, political, and the like conditions. In this case, delayed debt payment, payment of fine and the interest obtained from loans economically are more justifiable for client compared to loan settlement within due time.

Debtors who delay in paying the loan may have experienced insolvency and bankruptcy owing to some factors such as changing economic status including recession, inflation, sanction or disasters such as earthquake, fire or theft.

Banks should take some measures to collect debts and receivables by consideration of situation of delay or non-payment of clients using legal and contractual tools such as collaterals and guarantees. Accordingly, banks can refer to collateral or guarantee by submitting the case to judicial or registration authorities.

2. Punitive Measures

2-1. Payment delay compensation and penalty clause

There are four conditions for claiming payment delay compensation in Article 522 of Code of Civil Procedure of Islamic Republic of Iran approved in 2000. Accordingly, the obligation subject should be the cash, debtor should claim of the debt, debtor should have power of payment but avoiding debt settlement, and there is considerable change in money value at within payment due.

Although increased rate of current debts prohibits banks from reusing these sources in economy and benefiting from interest of the delayed debts, some scholars believe that punitive fee for delayed payment of current debts cannot support banks in case of compensation. The reason is that such penalties are enforced for one or two-day delays that cannot be the case of such punitive measures in terms of law and justices. Such compensation fee is fair if there is dramatic change in money value; hence, several days of payment delay cannot be defined as such debts.

2-2. Credit denial

Delayed collection of claims, accumulation of bank resources, and lack of reinvestment lead to disturbed the economic, states, and balance programs, policies and goals regarding bank profitability. The impact of such disturbance includes increase in extra cautionary reserves, decline in portability and efficiency of banks, lack of investment power of banks in economic projects, and most importantly reduction in lending power of banking system. Therefore, the financial institutions and banks do not grant further loans and facilities to compensate the loss and to prevent from excessive subsequent damages such as insolvency and bankruptcy.

Measures taken by banks in case of debtors' bankruptcy

1. Certain claiming debts

The debt should be a certain amount accepted by both parties and undeniable by debtor. Formal documents are important reasons for court investigation on the debt.

The claiming debts are accepted legally and legitimately in preconditions enacted in the law. In terms of banking affairs, the debts documents should be matched with relevant rules. Hence, if the claiming debt includes illegal trade such as wine, drugs, or smuggling, payment refusal is subject to verdicts issued by the court. In some cases, the banking contracts will be cancelled without issuing insolvency if the abovementioned cases are under procedure (for instance, the precedent vote NO. 99/2 794 dated on 11 Aguste 2020).

2. Unconditional, payable, commercial, and monetary nature of debt

According to Articles 412 and 413 of C.C and Articles 883 and 887 of N.B.C.C, debt should be unconditional and immediately payable. The conditional debt is not claiming until realization of suspended person when the time is not determined for deferred debt. In this case, it is wrong to express insolvency. It is also concluded that the debt is about the suspension of monetary obligations without generalizing it to other obligations such as delivery of goods or doing actions.

Lawyers have not reach a consensus on this case; some believe in separation of commercial and con-commercial debts while some others considers non-payment of debt the precondition for insolvency. The later do not distinguish commercial debts from non-commercial ones.

3. Detention of merchant

According to Article 905 of N.B.C.C, which is the integrated form of Articles 413 and 414 of C.C, if the merchant does not perform accord with the duties set in Articles 890 and 891 of this code and or if the freedom of insolvent merchant interferes with proceeding or enforcement of vote, the court should issue the one-month arrest warrant insolvency verdict mentioning the reason. Extension of above-mentioned vote subjects to remaining reasons arrest warrant issuance. However, this decision can be appealed within 10 days after notification in provincial court of appeal. This does not prevent the enforcement of judgment. In contrast, the arrest warrant in C.C was issued at the same time with order of bankruptcy while this warrant in the new bill is issued at the time of notifying insolvency.

4. Being or not-being charge of others' properties

Pursuant to Article 950 of N.B.C.C, "a merchant whose insolvency has been declared cannot be in charge of others' properties. Declaration of insolvency does not prevent merchant from exercising the guardianship upon properties of his/her offspring unless the case leads to loss of ward (child). In this case, the court annexes a trustee to the merchant."

Accord with Article 418 of C.C., "dating from the order of bankruptcy, the bankrupt is deprived of all his property and of any property which devolves upon him as long as he is in a state of bankruptcy." According to the abovementioned Articles, the merchant cannot be charge in his/her own property also is deprived of any other property in a prior manner.

5. Occupational and financial constraints

Pursuant to Article 1075 of N.B.C.C, "the bankrupt merchant, manager or managers and executive manager of bankrupt legal person are deprived of all social rights as subject of accessory penalties in Islamic Penal Code." Moreover, the mentioned persons cannot do following actions:

- A- founding commercial firm;
- B- membership of board of directors in commercial companies;
- C- taking responsibility as executive manager in business firms;
- D- acquiring credit and loans from public banks and credit institutions except from emergency loans such as housing and marriage;
- E- Carrying out any transaction with executive bodies.
- F- Geographical constraints

The innovative point of legislator in new bill of commercial code can be seen in Article 903 in which, the bankrupt is forbidden to leave. "Prosecutor immediately notifies the bankruptcy to associated institutes such as Real State Registration Organization, also the affiliated authorities are notified that the bankrupt is forbidden to leave the country." By forbidding the bankrupt to leave, the legislator tries to prevent the fraudulent and culpable bankrupt from escaping. In this case, creditors tend to prove bankruptcy by fraud.

Private and professional debt collecting authorities

1. Specialized Arbitration

Apart from criminal cases with unforgivable conditions that are investigated within the jurisdiction of public courts of justice administration, the other cases can be referred to the arbitration upon the mutual consent except for bankruptcy cases and disputes arising from marriage and its cancellation, divorce, and usury transactions.

2. Specialized deciding courts

In addition to justice and executive judicial authorities that are competent for investigating the cases by virtue of the collateral or guarantee based on the Commercial Code and Civil Law. According to Article 41 of Monetary and Banking Law of Iran approved in 1972 with amendments 2013, “(a)- In cases where a bank's failure or bankruptcy is pronounced, the Court shall seek the opinion of Bank Markazi Iran prior to arriving at any decision. Bank Markazi Iran shall submit its views to the Court in writing within one month of the date of receipt of the Court's inquiry. The Court shall take the appropriate decision with due regard to the views of Bank Markazi Iran and the evidence on hand;

(b)- Liquidation of a bankrupt bank shall rest with the Department of Bankruptcy;

(c)- In all cases of dissolution or bankruptcy of banks, settlement shall be carried out with the supervision of a representative from Bank Markazi Iran.”

3. Specific authorities responsible for claims

There has been an increasing attempt by the government to monitor and control banks' loans relying on financial discipline policy, inflation, and monetary base control. Specific authorities can follow up the deferred receivables and reduce the amount of outstanding claims by reforming banking and money market structure, controlling inflation, improving bank interest rate in line with inflation, justifying economic projects, validating credibility of customers and collaterals, and negotiating with bank debtor.

Banks will effectively contribute to economic boost if they are supported in collecting debts and obtaining more resources to grant new loans.

4. Use of specific banking mechanisms

Preventive ways to avoid expansion of deferred receivables include accurate monitoring over the applicant's projects and granted loans, credit validation using 4Cs method (including character, capacity, capital, and collateral) as well as 5Cs method (including conditions in addition to 4Cs) for applicant. In this case, LAPP validation method (including liquidity, activity, profitability, and potential) can be used for economic status of firm or 5Ps (people, purpose, payment, protection, and perspective) for economic unit when receiving loan.

The deferred receivables can be prevented by ranking companies, institutions, and even natural persons based on the scoring method of neutral credit validation institutes regardless of credit validation system of banks and financial institutions and precise investigation of projects. If an expert unit of specialized individuals who can investigate the projects proposed by the loan applicant is formed, bank resources will be spent in manufacturing and feasible sectors. Such board of experts can make proper decisions on applicant's incompetency if he/she breaches the obligation. Accordingly, the cases will be recorded via online system to prevent managers' influence on the case with their gold signature. In this regard, the government achieves its goals and banks can perform the monitoring process of projects more practically, professionally, rapidly by strengthening expert units by consideration of customer and investor satisfaction.

III. CONCLUSION

According to the published statistics about worrying situation of banks' deferred receivables in the recent years, many banks are bankrupt or becoming bankrupt. It is essential to study the reasons for such issue to avoid increasing the rate of outstanding claims. The economic conditions such as inflation, recession, sanction and some other issues such as

prevalence of viral diseases such as CO-VID19 or a combination of these incidents have prevented bank borrowers from being active in production and economic sectors. These borrowers then become debtors who are not capable of paying their debts to banks.

The most substantial factors leading to claims of assigned loans in recent years include economic status, difference between interest rate of these loans in formal monetary and unorganized monetary market, and lack of accurate investigation on the granted loans.

Reduced bank interest rate of loans can be named as the most important reason for intentional delay in payment of receivables received by speculators who tend to abuse the current situation of society and country's economy. Speculators receive large low-interest long-term loans based on their influence and relationships to benefit from the difference between interest rates of banks and market. These individuals are not obliged or interested in paying their debts believing that delay in paying debts bring much more profit for them.

As mentioned, projects proposed by applicants of loans should be monitored precisely in order to prevent deferred receivables. Such monitoring can be named as the most effective preventive method in case of outstanding claims. If a board of specialized experts is employed, banks can perform the monitoring process of projects proposed by loan applicants more practically, professionally, rapidly. Accordingly, the banks' sources will be used in considered governmental policies, infrastructures, production, and feasible economic projects regarding the government's objectives. The Iranian government has emphasized on use of bank's resources in manufacturing and industrial sectors relying on infrastructures to solve unemployment problem and to achieve economic growth in development programs within 5-year development plans. Hence, central bank can notify banks about outstanding claims to reach a developed economy. In general, deferred receivables will be reduced if all of the mentioned conditions are provided.

Recommendations

There are some recommendations to optimize methods of debt collecting or to eradicate such issue:

1. Founding ne monetary and financial institutes to mitigate credit risk of banks based on the balance sheet and profit-loss statement of individuals when granting loans to them. Preventing top managers from influencing the credit validation and ranking systems of banks. Designing software for credit validation system to alleviate the effect of personal opinions of managers with specific signature. Developing preventive programs to consider the credit allocated to clients based on the scoring and validation systems.
2. Creating a database and debt collecting system to enable systematic categorization of receivables in form of short-term, medium-term, and long-term loans. Identifying debtors based on their collateral to find past due and overdue receivables. Calculating reservoir of bad debts within a systematic mechanism.
3. Correct management of resources and expenses of banks and financial institutions and precise monitoring over the conditions in which, the granted loans are consumed. Monitoring the associated organizations to prevent from investing the loans in other sectors that have not been predicted in the loan contract.
4. Accurate enforcement of circulars and acts issued by central bank and monitoring the execution process. Sending information about granted loans and specific fraudulent cases.
5. Monitoring the financial statements, deposits, and account turnover of clients at the time of granting loans. Determining the exact amount of loans within a systematic mechanism without any human interference. Assuring the timely payment of debts based on the consistency between client's income and amount of loan as well as the compatibility between financial turnover and recorded, real, and paid capitals.

6. Creating a mechanism in which overdue receivables are recorded. Systematic registration of outstanding claims and overdue receivables. Designing warning systems to make bank officials aware of new receivables and their association with other organizations and individuals.
7. Empowering the expert board of banks to employ services provided by financial and investment institutions. Prompting knowledge level of experts and getting inquiries from important organizations such as Social Support Institution, Law Enforcement of Islamic Republic of Iran, Tax Organization, Finance Organization, and Justice Administration at the time of granting loans.
8. Monitoring the data of deferred receivables by debt collecting agencies. Having access to new information of branches' claims considering the type of assignment. Finding challenges and preventive factors leading to prolonged collection of receivables to remove barriers to collection of debts.
9. Preventing the subsidiary companies to use facilities granted by several branches of one bank or different branches of other banks. Paying attention to debt amount, recorded capital, and obligations of companies affiliated to the applicant of loan from several branches of bank and payment background of applicant. Preventing clients with large amounts of debts and overdue obligations from receiving loan from different banks.

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