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PLEDGE AND SURETYSHIP AS MAIN TOOLS FOR ENSURING CREDIT OBLIGATIONS

Introduction

Although the capital markets show some signs of development in the Republic of Armenia, the funding for business establishment or expansion still heavily depends on credit financing by credit organisations (universal credit organisations and banks). As banks mainly provide business credits only by applying the security of the fulfillment of the obligation, mainly by applying pledge and suretyship or requesting a secured right, most often, the obstacles to business development were because the businesses could not get the necessary credit because of the lack of proprietary asset of appropriate value for a pledge. Banks often apply other security, such as suretyship, in addition to the pledge, so the absence of a pledge leads to credit rejection.

To promote the development of the business environment Armenia has provided a broad scope of the pledge. In addition, the recent legislative changes have improved the legal status of guarantors and other risks that have prevented many people from being engaged as guarantors.

What can be the Subject of the Pledge?

Based on Article 230(1) and Article 232 of the RA Civil Code, the following property may be separated as collateral[1]:

1) any property, including monetary means, immovable and movable property, securities
2) property[2] rights, including the right to land development, right of use of property, right of servitude, including the rights to personal servitude, the right to purchase immovable property in a building under construction, the right of the claim (for example, the right to claim money from another person may be pledged)
3) appurtenances of the pledged property that is the property designated for serving the pledged property and connected to it by a common purpose
4) fruits, products, income obtained as a result of the use of the pledged property , and the property and property rights to be acquired in the future by the pledgor, in case it is explicitly mentioned in the contract of pledge.

Here we want to draw the attention of economic entities, particularly to the collateral provided for in point 4 above, as it allows them to apply directly to the bank for the necessary amount of credit even if they don't have their property necessary at the time. Recently, the broad involvement of such credit funds has been particularly tangible in production and among economic entities engaged in construction. Moreover, the RA civil legislation envisages a comprehensive regulation for the pledge (mortgage) of the immovable property under construction. In particular, according to Article 271 (1) of the RA Civil Code, when granting credit

1 except for the property removed from circulation, claims inherently and inseparably connected with the creditor, including claims for compensation of alimony, damage caused to life or health, those registered government (treasury) securities the conditions of the issuance of which will provide that the securities in question may not be pledged, and those rights the surrender of which to another person is proscribed by law.

2 For example, for obtaining credit funds the economic entity engaged in the production of solar energy may pledge not only the solar electricity generating system but also the expected income obtained from electricity resulting from its operation (offtake).

for construction, reconstruction, repair, renovation of a residential house, building or structure, security of the obligation by the land parcel, uncompleted construction and materials and equipment acquired for construction belonging to the pledgor may be provided for by the contract of mortgage.

Is it Possible to Re-Pledge the Property that has already been Pledged?

The RA legislation provides for the possibility of the pledged property becoming collateral for another pledge (subsequent pledge). Moreover, if until July 2016 it was envisaged that the subsequent pledge was allowed, in case it was not prohibited by the previous contracts of pledge, as a result of the amendments to the Civil Code, it was envisaged that the agreement restricting the right of a pledgor to turn the pledged property into collateral for another pledge (subsequent pledge) is null and void. In other words, the subsequent pledge may be concluded without the consent of the main pledgee, which substantially increased the number of subsequent pledges concluded in Armenia.

What Changes are Envisaged in the Legislation Concerning the Suretyship?

Before the recent amendments, the legislation provided that the guarantor bears joint and several liabilities for the debtor's obligation. The creditor independently decided from whom to demand the fulfillment of the obligation, from the debtor, from the guarantor, or both at the same time. From 1 January 2022, the guarantor, a natural person, will bear subsidiary liability for the debtor's obligations to the bank or credit organisation. That means that the guarantor may be required to fulfill the obligation instead of the debtor only if the debtor's property is not sufficient for the complete fulfillment of the obligations.

An exception to this rule is provided for when the contract of suretyship envisages the joint and several obligations of the guarantor, and at the same time:

1) the guarantor and the debtor are members of the same family. For the purposes of this paragraph, members of the same family are considered to be the spouse, the parents, the grandfather, the grandmother, the grandson over 18 years old, the child over 18 years old and his or her spouse, the sister, brother over 18 years old and their spouses and their children over 18 years old.
2) The guarantor is a member of the executive body of the debtor legal entity or a participant or shareholder of the debtor legal entity.
3) The guarantor is the real beneficiary of the debtor's legal entity or the sole proprietor.

The abovementioned means that if the guarantor (suretyship provider) is the shareholder or the beneficial owner of the business, they will not benefit from the new regulations. However, if the guarantor is a third-party individual, they shall have additional guarantees in case of non-fulfillment of the obligations by the creditor.

In addition, the bank or credit organisation shall be obliged to notify the guarantor that the debtor is unable to fulfill the obligation and only from that moment shall the guarantor have an obligation to pay instead of the debtor, which in its turn means that the guarantor shall no longer have an adverse credit history automatically from the moment the debtor fails to fulfill his or her obligation to the bank. The mentioned legislative amendments coming into force from the next year are undoubtedly a significant change to protect the guarantor's rights. We believe they will contribute to the involvement of individual guarantors (natural persons) and, hence, increase the number of credit funds received by the economic entities.