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METHODS OF GUARANTEEING THE PERFORMANCE OF THE OBLIGATION AS A MEANS OF CREDIT RISK MANAGEMENT

Abstract

Credit obligations are obligations arising from the credit agreement concluded between the parties. In order to ensure the implementation of obligations, a number of regulatory methods have been defined by legislation. A guarantee of credit is a set of conditions and obligations that ensure the creditor will be properly returned the loan and interest due to the use of the loan.

Loans are the biggest source of arising of credit risk. One of the most common and important risk mitigation techniques in financial markets is the use of guarantee. When concluding a loan agreement, the type, amount, term, etc. of the loan depending on the elements, a security agreement is also concluded to ensure the performance of the loan obligation.

Granting a loan with security both encourages the borrower to be more responsible in the performance of his/her obligations, and also compensates to a certain extent the damage caused to the credit institution if the loan obligation is not fulfilled by the borrower.

Keywords: *credit obligations, the performance of obligation, secured credits, credit risk, credit risk management*

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Öhdəliyin icrasının təmin edilmə üsullari kredit riskinin idarə edilməsi vasitəsi kimi

Xülasə

Kredit öhdəlikləri tərəflər arasında bağlanmış kredit müqaviləsindən yaranan öhdəlikləridir. Öhdəliklərin icrasını təmin etmək üçün qanunvericiliklə bir sıra tənzimləmə üsulları müəyyən edilmişdir. Kreditin təminatı kreditora kreditdən istifadəyə görə kredit və faizlərin lazımi qaydada qaytarılmasına əminlik yaradan şərtlər və öhdəliklər məcmusudur.

Kredit riskinin yaranmasının ən böyük mənbəyi kreditlərdir. Maliyyə bazarlarında ən ümumi və əhəmiyyətli risk azaldılması texnikalardan biri də təminatın istifadəsidir. Kredit müqaviləsi bağlanılarkən kreditin növündən, məbləğindən, müddətindən və s. ünsürlərdən asılı olaraq kredit öhdəliyinin icrasını təmin etmək üçün həmçinin təminat müqaviləsi də bağlanılır.

Kreditin təminatla verilməsi həm borcalanı öz öhdəliklərinin icrası zamanı daha məsuliyyətli olmağa təşviq edir, həm də borcalan tərəfindən kredit öhdəliyi icra olunmadığı təqdirdə kredit təşkilatına vurulmuş zərəri müəyyən səviyyədə kompensasiya etmiş olur.

Açar sözlər: *kredit öhdəlikləri, öhdəliyin icrası, təminatlı kreditlər, kredit riski, kredit riskinin idarə edilməsi*

Introduction

According to the credit agreement, the creditor undertakes the obligation to give the money (loan) to the debtor in the amount and conditions stipulated by the agreement, and the debtor undertakes the obligation to return this amount and pay interest.

Honest fulfillment of obligations arising from contracts primarily serves the legal interests of the parties and the stability of civil circulation. At the same time, the timely execution of obligations under the loan agreement is aimed at the stability and development of the economic and financial situation of the state, which results in the protection of the economic security of the country and the provision of an even higher standard of living of the population by having a positive effect on the trust shown to the banks by the depositors (1).

As in other obligations, bank contract obligations also have an important place in the methods of guaranteeing the obligation. In particular, when issuing large-scale loans, banks choose one of the methods specified in the civil legislation to secure the loan amount (Mirzəyeva, Əliyeva, Hacıyeva, Abbaslı, 2023: 77).

Pursuant to Article 460 of the Civil Code of the Republic of Azerbaijan, the performance of obligations can be ensured by pledge, liquidated damages, debtor's property withholding, suretyship, warranty, advanced money and other methods provided for in this Code or the contract. The invalidity of the agreement to ensure the performance of the obligation does not lead to the invalidity of the main obligation (Azərbaycan Respublikasının Mülki Məcəlləsi, maddə 460).

Some of them can be used only in bank contracts (warranty), and some can be used in bank credit contracts (pledge, surety) along with other relationships.

Secured loans are loans granted by obtaining personal and/or material collateral in order to reduce risk. The company/individual cannot withdraw collateral until the loan is closed, the risk is completely eliminated and it is determined that it has no further obligations towards the bank. Secured loans are divided into two: material and personal (4).

Due to the failure of the borrower to repay the loan, or rather, as a result of issuing risky loans, financial institutions face credit losses. In the literature, these losses are presented in two forms. The first is expected losses and the second is unexpected losses. The history of credit risk goes back to ancient times. Thus, in the ancient "Laws of Hammurabi", terms such as "interest" and "guarantee" are found (Azərbaycan Respublikasının Mərkəzi Bankı, İşçi Məqalələri Silsiləsi № 11/2014, C.Abbasov, 2-3) .

Article 2.1.1 of the Rule "Management of Credit Risks in Banks" defines credit risk as follows: the risk of loss as a result of the inability of the borrower, issuer or counterparty to fulfill its obligations in accordance with the terms of the contract ("Banklarda kredit risklərinin idarə edilməsi" Qaydası, maddə 2.1.1)

Credit risk is the credit customer's failure to comply with the terms of the contract made between herself/himself and the financial intermediary providing the loan, by acting contrary to the rules that form the basis of the credit relationship.

Loans are indispensable financial resources in terms of ensuring economic development in countries. In order to grow and keep up with developments quickly, businesses meet their funding needs with loans they receive from banks. Since loans are a medium of circulation, they reduce the carrying of cash and accelerate commercial transactions. Through the credit system, unused funds are transferred to those who need money as loans, providing income to the fund owners and ensuring supply and demand mobility in the economy (4).

The main purpose of evaluating loan requests is to minimize the credit risk faced by the bank by determining the loan repayment capacity of the person or company requesting the loan and to ensure that the loan is granted in an amount and maturity appropriate to the needs of the loan requester. Evaluating loan requests is also called credit analysis. When evaluating loan requests, issues such as whether the real value of the material collateral has been determined by experts and whether there are any restrictive rights such as liens or mortgages should be examined. In personal guarantees, issues such as the character of the person giving the guarantee and his ability to pay the debt should be investigated, just like the person requesting the loan (4).

Banks can use different types of guarantees and transaction structure to assist reduce risks associated with particular credits, but the primary basis for entering into a transaction should be the borrower's ability to repay the loan. Guarantee cannot make up for incomplete information or serve as a stand-in for a thorough evaluation of the counterparty or borrower. Recognizing that credit enforcement procedures (like foreclosure proceedings) have the potential to erase the transaction's profit margin is important. Furthermore, banks must be aware that the same reasons that have made the credit less recoverable may also reduce the value of the guarantees. Financial institutions have to possess regulations pertaining to the admissibility of diverse types of guarantees, mechanisms for the continuous assessment of this guarantee, and a method the guarantee`s enforceability and realisability. Banks should assess the extent of coverage offered in respect to guarantees in light of the guarantor's legal competence and creditworthiness. When assuming implied backing from other parties, such the government, banks should exercise caution (7).

The occurrence of credit risks at the level of loans can be caused by:

- Borrower's lack of funds for debt repayment and loan servicing
- Liquidity risk of guarantee
- Failure to fulfill obligations of third parties responsible for the loan
- Personal qualities of the borrower (8).

Regulations related to the management of risks arising from credit obligations are contained in the Law "On Banks", the Rule "Management of Credit Risks in Banks", the Rule "On Prudential Normative and Requirements for Credit Risks, including Large Credit Risks", the Rule "Creation of special provisions for classification of assets and compensation of possible losses" approved by the Management Board of the Central Bank of the Republic of Azerbaijan etc. can be seen in other legal acts.

According to Article 3.1 of the "Credit Risk Management in Banks" Rule, one of the elements of the credit risk management system in Banks is guarantee assessment ("Banklarda kredit risklərinin idarə edilməsi" Qaydası, maddə 3.1)

According to Article 5.5 of the Rule "On Prudential Normative and Requirements for Credit Risks, including Large Credit Risks", in addition to the requirements defined in the normative act regulating credit risk management in banks, at least the following conditions must be met:

5.5.1. the bank's rights on the security must be formalized in accordance with the legislation;

5.5.2. the duration of the guarantee must not be less than the duration of the obligation it provides;

5.5.3. the market price of the guarantee must be reevaluated at least once a year;

5.5.4. there must be a liquid market for the sale of guarantee. ("Kredit riskləri, o cümlədən iri kredit riskləri ilə bağlı prudensial normativ və tələblərə dair" Qayda, maddə 5.5)

In order to assess the credit risks of the borrower, his solvency is assessed. One of the issues to be considered at this time is the loan-to-security ratio if there is collateral for the loan.

Article 7 of the Rule on "Credit Risk Management in Banks" defines the requirements that must be taken into account for each type of guarantee during the evaluation of the guarantee under the loan agreement.

When a suretyship acts as a guarantee, it is considered that the surety is a guarantor for several credit agreements at the same time, as well as that the borrower and the surety are mutual guarantors for each other's loans. The surety's solvency is assessed in accordance with Part 5 of this Rule;

When a warranty acts as security, the guarantor's solvency is assessed in accordance with Part 5 of this Rule;

When movable property acts as collateral, its encumbrance is checked in the State Register of Encumbrance of Movable Property, as well as its market price and sales possibilities are analyzed;

When real estate acts as collateral, its market price and sales possibilities are analyzed;

When securities act as collateral, its market value, the issuer's solvency, and the possibility of selling the securities are analyzed;

When the pledge of rights acts as security, the legal validity of the subject of pledge, and when the debt claim acts as security, the solvency of the relevant debtor is assessed in accordance with Part 5 of this Rule.

Conclusion

Credit agreements involve the creditor providing a loan to the debtor in the agreed terms and conditions, while the debtor is responsible for returning the loan and paying interest. Loans are crucial for economic development, as they help businesses meet funding needs, reduce cash carrying, and facilitate commercial transactions. Timely execution of credit obligations contributes to economic security and a higher standard of living. Secured loans are granted by obtaining personal or material collateral to reduce risk. Credit risk arises when a credit customer fails to comply with contract terms. Loan guarantees are evaluated to minimize credit risk and ensure appropriate loan amounts and maturity.

Banks use guarantees and transaction structures to reduce credit risks, but the borrower's ability to repay the loan should be the primary basis. Credit enforcement procedures can erase transaction profit margins, and guarantees' value may be reduced by less recoverable credit.

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