THE LEGAL QUAGMIRES FACING LENDING AND SECURITIZATION TRANSACTIONS BY FINANCIAL INSTITUTIONS IN TANZANIA

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ABSTRACT

Financial institutions play a major role in the general status of any country's economy because they are financial intercessors whose principal purpose is to assist the management of financial assets vis-à-vis the people's business concerns and financial needs. In Tanzania, commercial banks stand out as the most dominant of financial institutions with the issuing of loans been the most essential service offered. The challenges found in the lending and securitization dealings often babble up at the loan recovery stage due to faulty pre-contractual loan and mortgage processes between financial institutions and their potential borrowers, a main cause for potential bad loans and non-performing loans stemming out early on and way before loan recovery procedures set in; leading to the tedious legal disputes between the parties to the contracts in related civil and commercial cases. Despite the suitable banking and financial laws and regulations set on lending businesses, there is still a need to fine-tune the regulatory control on pre-contractual lending procedures through examining the factors resulting to ineffectual pre-contractual loan processes and the common subjects of disputes in court cases, so that a better grip on efficient lending and securitization procedures by financial institutions will be accomplished.

INTRODUCTION

Financial institutions are regarded as financial intermediaries whose principal function is to manage the financial assets of businesses and individuals.[i] The most common categories of financial institutions in Tanzania include the central bank, commercial banks and other specified financial institutions such as investment banks, insurance companies and other savings and loan associations. Among these financial institutions in the country, commercial banks stand out as the most dominant because as of 2021, banking reportedly continued to dominate the financial sector in Tanzania, providing services related to accounting for roughly 70% of financial assets, followed by pension funds at 27% along with insurance companies and collective investment schemes at 2% and 1% respectively.[ii]

The activities and dealings of financial institutions in Tanzania are supervised and regulated mainly by the Bank of Tanzania Act as well as the Banking and Financial Institutions Act,[iii] under which the leading financial transactions conducted by commercial banks involve the business of receiving funds from the general public through acceptance of deposits payable on demand or after a fixed period of time, and to use such funds in whole or in part, for issuance of loans to the persons requesting such business.[iv] Henceforth, loans are clearly a way that these financial institutions develop the general money supply in any state economy and enhance the business operations; they are the primary source of income to the operations of commercial banks and financial institutions at large.

Despite the commercial bank dominance among financial institutions in the country, there has been an increased occurrence of bank disputes,[v] associated among other things with non-performing loans and difficulties in recovering the loans issued to their customers. Such difficulties stem up when the borrower defaults and the bank seek to realize the security in order to recover the loan amounts.

In view of this, the core of this study was to examine the implementation of the banking and financial institutions laws associated in the issuing of loans as well as the specific legal and practical challenges faced by the banks as financial institutions in the realization of securities including when court intervention arises, along with the alternative ways that such ineffective loan recoveries are worked out. This will enable scrutinizing the loan recovery procedures so as to assess the efficiency of strategies put in place before approving loans to borrowers and hence, establish proper strategies to be added in place in order to cater for competent loan and mortgage contractual transactions.

CATEGORIES OF FINANCIAL INSTITUTIONS IN TANZANIA

Central Bank

Central banks are the banks that exist in most countries and are usually controlled and owned by the government of the particular country, they do not directly deal with the public. A central bank is therefore a public financial institution given privileged control over the production and distribution of money and credit for a nation or group of nations; it is often responsible for the formulation of monetary policy and the regulation of member banks.[vi] Examples of central banks are the Bank of Tanzania within Tanzania and the European Central Bank of the 19 European Union countries.

Commercial Banks

These are banks that play the most important role in a country's economy, dealing with the business of receiving deposits, offering loans and advice on investment as well as financing trade transactions within the country.[vii] Commercial or otherwise referred to as corporate banks, are banks that provide their banking services to business clients from small business owners to large, corporate entities; they offer along with day-to-day banking business services, cash management, trade finance and credit services.[viii] Best example of a commercial bank is the CRDB Bank Plc.

Investment Banks

Investment banks are the banks that act as intermediaries in large and complex financial transactions, usually between a corporation and financial markets by pre-underwriting counselling, helping corporations issue stock shares as well as arranging debt financing for corporations by locating large-scale investors for corporate bonds.[ix] The Tanzania Investment Bank (TIB) is a good example of an investment bank.

Bureaux De Change

Bureaux De Change which is French for 'office of exchange' refers to a financial institution where customers can exchange money of one currency for money of another currency, thus they are institutions which deal with foreign exchange of money. In Tanzania, such offices are found in respective offices like the Lake *Bureau De Change* and Posta *Bureau De Change*, in airports such as the Julius Nyerere International Airport, as well as in commercial banks.

Financial Leasing Companies

Financial leasing companies are companies which engage in financing the purchase of tangible assets, a situation whereby a customer would identify an asset and then a bank as a financing entity (lessor) would pay for that asset, then the company would make use of the asset with the agreement or contact that the customer (lessee) will make periodic payments.[x] An example of financial leasing companies is the Equity for Tanzania Ltd. (EFTA), which provides leasing contracts for farmers, producer groups as well as Small and Medium Enterprises (SME).[xi]

Mortgage Finance Companies

A mortgage finance company is a specialized financial firm engaged in the business of funding mortgages for residential or commercial property; the company is often just the originator of a loan, marketing itself to potential borrowers and seeks funding from one or more client financial institutions that provide the capital for the mortgage itself.[xii] Examples of mortgage financing companies include the Tanzania Mortgage and Finance Company (TMRC) and the First Housing Finance (Tanzania) Ltd.

Tier 2 Microfinance Service Providers

Microfinance service providers are financial entities or persons registered or licensed to undertake microfinance businesses including deposit and non-deposit taking services, thus tier 2 microfinance service providers are categorized according to the *Microfinance Act*[xiii] comprising of non-deposit taking microfinance service providers such as individual money lenders. Examples include the NMB Bank Plc and Tier 2 Microfinance Service Providers (Individual) include the likes of *Tujijenge* Tanzania.[xiv]

CLASSIFICATIONS OF LOANS OFFERED BY TANZANIAN FINANCIAL INSTITUTIONS

Loans Based on Repayment Period

This refers to a category of monetary loans issued with agreements to be repaid in regular payments or installments over a given duration while the principal of a term loan is not technically due until maturity.[xv] **Satta**[xvi] notes that a grace period is usually given before loan repayments begin. Hence, depending on a particular financial institution such loans can be categorized into short term, medium term or long term loans, reflecting the lifespan of the loan.

Loans Based on Amount

This is the classification of loans that are issued based on the monetary amount offered, that is, the total loan amount that one is authorized to borrow on a line of credit, personal loan or mortgage. It depends on factors such as a borrower's creditworthiness, timespan of the loan, purpose of the loan, if the loan is secured and other criteria set by the lending institution.[xvii] This classification of loans goes hand in hand with loans classified based on repayment periods such that;

i. **Short-term loans;** otherwise recognized as small scale loans, are loans which are usually offered to customers that do not qualify for a line of credit, running less than a year to 18 months.[xviii] Such loans are in likes of boom advance loans offered by CRDB Bank Plc which involves a designed loan specifically for students of higher learning institutions with an automatic repayment lifespan as soon as Higher Education Students' Loans Board (HESLB) issues their allowances.[xix].

ii. **Medium-term loans;** similar to medium scale loans, are the loans generally issued between one to three years, paid in monthly installments from a company's cash flow.[xx] For instance, medium scale loans offered at NMB Bank Plc are offered to contractual or permanent employees of both government and private institutions with loan repayment terms varying from 1 to 6 years.[xxi]

iii. **Long-term loans:** or large scale loans are loans that last anywhere from 3 to even 30 years, using company assets or immoveable property as collateral and require monthly or quarterly payments from profits or cash flow.[xxii] In Tanzania for instance, such a loan is offered with a repayment period of up to 20 years by CRDB bank usually with a repayment condition through monthly or balloon payment.[xxiii] NMB Bank on the other hand, offers executive loans specifically for senior executives, managers, heads of departments, directors, chiefs, project coordinators as well as high net worth individuals, with a maximum loan amount of TZS 150 million.[xxiv]

Loans Based on Security Attached

This classification of loans simply classifies loans into those which are secured and those which are not secured whereby, unsecured loans are loans issued without requiring the borrower to offer any asset as security; while the secured loans mean issued loans backed by some form of security or collateral. With unsecured loans, the lenders are very thorough when assessing the borrower's financial status in order to estimate the recipient's (borrower's) capacity for repayment and decide whether to award the loan or not.[xxv] Good examples of unsecured loans are student or education loans and personal loans. Secured loans on the other hand, are such as mortgages or secured personal loans.

A legal claim imposed on a borrower's property that allows a bank or financial institution as the lender to repossess the property and sell it if a loan default occurs, is what is referred to as loan securitization. Hence, such a feature influences loan recovery that is why banks need to carefully assess the credit standards of borrowers as, **Dermine (et al)**[xxvi] found that the size of loan has a negative correlation to the actual rate of repayment cumulatively for 12 to 48 months after the loan default. In banking practice, security interest can be categorized into;

Personal Property Security

Personal property security means the guarantee given by the borrower or by a third party in the loan agreement by pledging tangible assets or chattels that is, almost any property except land and buildings. It is hence secured through chattel mortgage which is the legal secured loan contract whereby the purchaser borrows funds from a lender for purposes of purchasing a movable property or the chattel.[xxvii]

Real Property Security

Real property security is a security interest that a lender holds by taking physical control of a property or underlying asset that has been set forth as collateral to secure a debt or other financial obligation,[xxviii] as set out in a mortgage deed. The mortgage deed is a document that imposes a *lien* on the title to the real property as security for a loan, allowing the lender (mortgage holder) to foreclose on the financing if the borrower (mortgagor) fails to repay the loan or otherwise perform as specified in the agreement.[xxix]

A Mortgage is thus a proprietary security that empowers the lender to appropriate the property rights upon default by the borrower, sometimes referred to as nonpossessory *lien* whereby the borrower is usually the one who holds the security while the loan or financial obligation is in repayment.[xxx] Mortgage is categorized according to the *Land Act*[xxxi] as follows;

Customary Mortgage

This is basically the mortgage of a customary title whereby the customary law regulates the creation and operation of its mortgages in Tanzania,[xxxii] to the extent that if there is a gap under the customary law, the *Land Act* applies.[xxxiii] In Tanzania, customary laws are unified and codified by the *Local Customary Law (Declaration)(No.4)Order;*[xxxiv] unfortunately the codified law falls short of land law matters concerning mortgages as it does not provide any guidance or regulation on mortgages.[xxxv] This was set out in the case of Muhema Bin Said v. The Registrar of Titles,[xxxvi] where the court held that the Sukuma customary law did not have concept of ownership of land by an individual in the form of free hold title. To this circumstance, it is evident that creation of mortgage financing is tied up with technicalities when it comes to granting customary mortgages.

Formal Mortgage

Formal mortgage is the mortgage created over a legal estate or property or a legal interest in land subject to conditions stipulated under the *Land Act* on formalities for the creation of mortgages. It is further stipulated under the *Village Land Act* that legal interest over land in Tanzania, is categorized into granted right of occupancy and customary right of occupancy which are of the equal effect and status.[xxxvii] Mortgage requires registration in accordance with the provisions of the *Land Registration Act* and to the registrar of titles so as to be effectual.[xxxviii]

Informal Mortgage

An informal mortgage is a mortgage that involves a written and witnessed undertaking offered by the borrower and accepted by the lender showing the clear intention of charging the borrower's land with the repayment of money or money's worth obtained from the lender.[xxxix]

In their book, **Clark (et. al)**[xl] noted that the concepts mortgages and charges have been used loosely as if they refer to exactly the same thing but a mortgage is actually security created by contract whereby the creditor acquires interest in the debtor's property. On the other hand, a charge is a security whereby property is expressly or constructively made liable for the discharge of a debt or any other obligation.[xli]

Lien by Deposits of Documents

This is the kind of mortgage created through a deposit of a certificate of Granted Right of Occupancy (GRO) or of Customary Right of Occupancy (CRO), a lease agreement, or any other document signifying ownership of land by the mortgagor to the mortgagee or lender. This element is usually embedded within all mortgages offered by banks in Tanzania as lenders always require so until the loan advanced is repaid. As Peter Gibson LJ stated in the case of United Bank of Kuwait Plc v. Sahib[xlii], the deposit of document constitutes a sufficient act of part performance to create a mortgage as construed from the provisions of the *Land Registration Act.*[xliii]

Third Party Mortgage

A third party mortgage is the mortgage that is executed by securing another person's debt by a person who is not the original mortgagor (thus, a third party). Fulfilling the conditions of this mortgage is in a way that a lender seeks a third party security which can be treated as guarantee.[xliv] The third party, who becomes a guarantor, assumes loan liability of the borrower, who becomes the principal debtor of the loan in the event of default.[xlv]

Third party mortgage is applicable in Tanzanian banks and financial institutions as in the case in Bank of Africa Tanzania Limited v. Rose Miyago Assea,[xlvi] the plaintiff filed a suit against the defendant who mortgaged Plots No 662/1, 662/1, 689/1 Block C Ukonga Sitaki Shari, Dar es Salaam so as to secure a third party loan.

THE LEGAL CHALLENGES FACING MORTGAGE VIS-À-VIS LENDING TRANSACTIONS

The formalities for the formation of mortgage over landed properties and thus the later loan recovery processes have been found to be riddled with issues in ranging from borrowers' discrepancies to bank loan officials' irresponsible fulfillment of duties and court interventions.

These challenges are established from bank loan administrative operations in relation to the banking regulations put in place within Tanzania to the extent that;

Within the Banks

Failures and shortcomings have been reported and observed based on banks' internal policies and employee failures as factors which affect borrowers and this required examining the loan credit policy used by banks and financial institutions, as regarding:

Underwriting issues

The *Banking and Financial Institutions(Mortgage Finance) Regulations* provides for a bank's mortgage policy to include underwriting criteria to be applied in evaluating application for mortgages prepared and submitted to the BOT for review.[xlvii] This is still an issue that is violated as an attempt to boost bank lending businesses and in blinding bank underwriting procedures because in the first instance, it is due to failure of the bank officials in efficiently running financial background checks and the inaccuracy of borrowers' financial turnovers in their businesses.

On the other instance, it is due to the conniving of both the bank officials with the potential borrowers so as to bring in more lending businesses to the extent of falsifying information regarding the borrowers' sources of income or security value and target of investment upon been granted the loan money. Such bank internal failures also consider loan credit and mortgage policies which favor bank interests without looking into the borrowers, thus poor credit policies which create room for NPLs and bad loans resulting to inefficient loan recoveries.

Proof of Ownership for the Security for Loans

This issue is persistent due to factors relating to co-ownership of properties especially with spouses, as well as with land properties owned under customary laws. In the latter case, procedures for creation of mortgages are usually considered informal leading to some unpredictable interference in the future, such as relatives who are not party to the mortgage claiming interest rights over the land like in the case of Agripina Revelian v. Savera Aloys Lukaza.[xlviii] And in the former regarding spousal consent, issues of deceit regarding whether or not a potential borrower's spouse actually signed and consented to a matrimonial home securing a loan have posed a setback to loan recoveries, in the sense of setting up the processes of validating property ownership before granting loans in jeopardy.

Inquiry into the Securities for Loans

The difficulty here is on the basis of acquiring accurate information about a property submitted as security which is often riddled with issues of misleading customers, customary owned land and incompetent underwriting performances. For customary owned land it has been because as noted earlier, ownership of such securities is not preserved in any formal documents which complicates identifying encumbrances if any, subsisting over the land. As the *Land Act* states, such land's information in the register is valid but indefensible.[xlix]

Regarding misleading customers, on what their sources of income or business turnovers are as well as due to incompetent underwritings, lead to a failing assurance for a sturdy loan security. These trivialities are therefore concerning the requirement of mortgage financing to be in writing, requirement for notification to the commissioner for lands, registration by the registrar of title and on the mortgagor been required to report on the utilization of the mortgage money granted per *Land Act* and its subsidiary legislations.[l]

Alternate Loan Recovery Techniques

Common alternative loan recovery methods preferred by financial institutions have been loan restructuring and loan refinancing which necessitate reliable maintenance of communications between lenders and borrowers since it is essential for negotiations. Through this, in return for loan restructuring, borrowers can even offer or agree to conduct sales of their collaterals and use the proceeds required to repay the loans or debts owed.[li]

Transferring a loan to a new property or new borrower or guarantor, is also accepted by banks as long as the guarantor is a blood related relative and before cases end up in court or sale of collateral or security is triggered, a standard demand letter and notice for repayment is usually issued to a borrower.[lii] Failure to respond or repay the loan amount leads to the lenders enlisting an auctioneer's services, who as the provisions of *Auctioneers Act* provide, also issues a standard of at least 14 days' notice before public auction of the collateral ensues.[liii]

External Factors

These are factors challenging lending and loan recovery operations by banks and financial institutions brought upon by external sources including;

Customers' Discrepancies

These are as observed earlier, dishonest and misleading actions by borrowers which have added on in hindering successful loan recovery operations by banks and financial institutions. This culminates from during bank underwriting processes, when customers mislead the bank loan officers, individually and in other instances in cahoots with the loan officers. This is done by stating and presenting false sources of income with the aim of securing large loan amounts. Eventually, upon borrowers' default, recovery is hampered when collecting the actual value of property or assets since the banks were initially misled.

The Influence of the Covid-19 Pandemic

The essence of examining this in the banks, law firms and in the tribunals and courts regarding the status of loans eversince the pandemic hit by 2020 was so as to examine the influence that was reportedly on the state financial and economic status, to the extent of affecting lending businesses in financial institutions.[liv] The study found that indeed the Covid-19 pandemic left a gap in lending businesses to the extent that most borrowers faced failures in repaying loans due to declining profits to businessmen and entrepreneurs. In other cases complete dismissal of jobs and thus extinguishment of the salary factor held back borrowers whose sources of income depended on their employments.[lv]

Briefly speaking, unpredictable bubble bursts on financial or economic markets influence either an advancement or depletion on business proceeds similar to the 2007-2008 global financial crises.[lvi] On a less negative note, with borrowers reporting decreased business turnovers, banks had to begin offering better loan restructuring workouts and lower interest rates so as to maintain their lending businesses.[lvii]

Court Involvement

It is no new revelation that court proceedings take long based on the complexity of a case's subject matter until its final judgment. A result often times contributed by continuous filing for appeals until the Court of Appeal of Tanzania gives a final verdict. Further, amidst the Covid-

19 pandemic most case proceedings had to undergo adjournments and reschedules due to health concerns which also resulted to the delay of most case proceedings.

Moreover, since there is no system of rules or regulations which employ a sort of speed tracking for cases involving loan or mortgage disputes like that assigned to standard civil cases under the *Civil Procedure Code*,[lviii] it is no wonder that court proceedings in the District Land and Housing Tribunals to the High Court-Commercial Divisions often take months to years until they are resolved.

RECOMMENDATIONS

To the Banks and Financial Institutions

- The loan officers and auctioneers employed or enlisted should be employed based on strict background checks and enough legal knowledge regarding the lending businesses and the necessity of ensuring that only air-tight securities and borrowers' credit scores are accepted for granting of loans and mortgage creations. Loan officers should make close follow ups with auctioneers so as to ensure that all the public auction proceedings are legally sufficient and that the auctioneer's report corresponds with the contents of the certificate of sale.

To the Legislature

The Government as the initiator of policies and laws in the state should set forth the following adjustments to the financial community and public such that;

- The laws governing banking businesses in Tanzania should be amended or fine-tuned in a way that fills in the gap concerning the regulatory control on due diligence conducted by banks' and financial institutions' loan officials to the extent of cementing the formalities that a loan secured by land properties or business assets have to fulfill for an enforceable mortgage to be created. In addition, the procedures relating to land owned under customary laws and the procedures in filing caveat should be strengthened to the extent of making it effectual for the public to take part of responsibly.

- A proficient credit rating system should be created between the borrowers and lenders and accessible to both parties so as to eradicate the persistent number of fraudulent practices by borrowers such as in terms of serial defaulters or funds deviation and misleading financial reporting. This will keep track of both good and bad borrowers as well as which are better and which are worse lending institutions.
- There is the need to create an efficient educational outreach to the public regarding how and when they should protect their interests regarding mortgage created on land or properties co-owned amongst one another, especially within blood-related relatives and with marriages or spousal relations.

To the Public

- Consulting legal practitioners or clinics in the community would work in their best interests so as to ensure that they know how and when to protect their interests before or in the process of creating mortgages, as well as to ensure that the loan and mortgage contractual terms entered into are not those which will turn against them later during loan recovery or repayment operations.
- Maintaining a good working relationship with bank loan officials during the course of loan or mortgage contract is also important so that in the event that there is failure or potential failure to repay the loans, negotiation talks of alternative loan workouts can be employed in favor to the borrowers' financial recovery.

CONCLUSION

The study in examining its general objective on circumstances which persistently challenge lending operations by financial institutions within Tanzania traced issues as far back as during initial talks between the financial institutions and their potential borrowers. Further, the current laws and regulations on lending businesses lack in regulating the loan proceedings secured by customary owned land and in looking into possibly fast tracking case proceedings in the courts and tribunals. Thus, this forms another legal conundrum to the efficiency of loan recovery operations by financial institutions in Tanzania with the fact that registered and unregistered land are of equal status.[lix] In consequence, this is another point upon which disputes between parties to a loan and mortgage agreement arise, with borrowers being the frequent parties who initiate complaints to the courts and where temporary injunctions are requested and granted, putting sale of securities and loan recovery operations at bay.

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