



## **Legal & Regulatory Aspects of Leasing**

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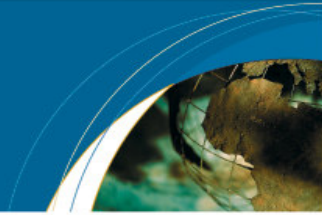
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**IFC** | **International  
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# Leasing Is a form of Asset Finance



**Asset Finance:** A method of lending in which lenders look primarily to the cash flow from a particular asset for repayment.

## Features of Asset Finance:

Usually no additional collateral required apart from the asset financed.

Asset's ability to generate cash flow is important in the lending decision.

**Compare with Asset Based Lending:** A flexible form of finance which allows businesses to secure funding against debtors (via invoice discounting and factoring), stock, plant and machinery and property.

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# Finance Leases Distinguished From Other Credit and Asset Agreements

- **Conditional Sale:** A sale of goods in which the buyer gains immediate possession of the goods but the seller retains title until the buyer performs a condition, especially payment of full purchase price (United Kingdom).
- **Installment Sale:** A conditional sale in which the buyer makes a down payment followed by periodic payments and the seller retains title or a security interest until all payments have been made (South Africa).
- **Credit Sale:** An agreement for the sale of goods, the purchase price being payable by 5 or more installments, not being a conditional sale agreement. Under such agreements the ownership of goods passes to the buyer at once, and he may therefore pass on good title to another person (United Kingdom).

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# Leases Distinguished From Other Credit and Asset Agreements

- **Finance Lease:** A fixed term lease used by a business to finance capital equipment. The Lessor's service is usually limited to financing the asset, and the lessee pays maintenance costs and taxes and has the option of **purchasing** the asset at the lease – end for a nominal price.
- **Hire Purchase:** is decisively a financing transaction. A Hire - Purchase agreement is an agreement to finance the acquisition of goods. However, a H.P. may be different from a FL with regard to purchase options, use thereof ( e.g. consumer goods or for consumers). HP is a common law concept, remains in statute books but it has either: never/ rarely been used or a historical concept.
- **Operating Lease:** A lease of property, especially equipment for a term that is shorter than the property's useful life. Under an operating lease, the lessor is typically responsible for paying taxes and other expenses on the property.

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# What is a Lease/ Finance Lease?

Generally speaking, a lease is a contract between two parties whereby one party (the “lessor”) lets another party (the “lessee”) use an asset in exchange for regular periodic payments. A lease separates ownership of an asset from its use.

**The Business logic of leasing:** One does not have to own an asset to use it for production and to generate profits.

**Legally & Historically:** A lease (as with a Hire Purchase) is a contract of bailment. There are different types of bailments. A bailment is an entrustment of goods/ a party (the “bailor”) gives possessory rights to goods to another party the “bailee”)

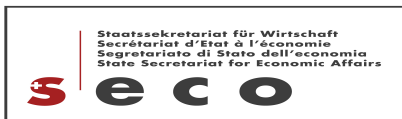
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# Finance Lease

- A FL is a financing device/ mechanism - Financial lessors, are normally financial intermediaries. Financial lessors are not vendors, even though a leasing company may be a captive. i.e., a subsidiary of an equipment supply company e.g. Caterpillar Financial Services Inc., IBM Global Financing, Ford Motor Credit etc)
- A finance lease is not a sale or an agreement to sell; although a transfer of title to the goods may take place at end of the lease term - compare with England and India where legally a lease does not contain a purchase option. However, this is more of a legal fiction to distinguish a lease from a Hire Purchase.

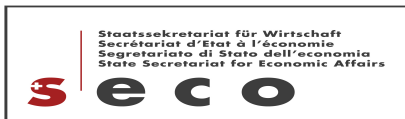
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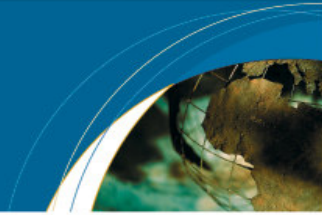
# Finance Lease

- A finance lease is not a pledge or a mortgage of assets by a borrower (lessee) to a creditor (lessor) in return for credit advance. The assets/ goods do not belong to the lessee, but to the lessor.
- Amortization of all or substantially the whole of the cost of the asset (plus element of profit). Compare with practical experiences in the United States, i.e., large equipment suppliers; Convention on International Financial leasing; Ghana legislation.
- Typically written for capital and business assets; not for consumer type assets. Hire Purchase and remnants thereof.

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# UNIDROIT Convention on International Financial Leasing



- **UNIDROIT** – International Institute for Unification of Private Law, (<http://www.unidroit.org>) based in Rome, Italy. UNIDROIT is not part of the UN system. States are members - Tanzania is not. In Africa: Tunisia, South Africa and Nigeria are members.
- UNIDROIT activities include to harmonize private law amongst and between states. In 1988 UNIDROIT was instrumental in drafting the Convention on International Financial Leasing (“the Ottawa Convention”). Tanzania has not ratified the Convention.
- The Ottawa Convention provides a framework for cross border leasing between States that are party to it. The Convention recognizes financial leasing as a “three party arrangement.”

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# UNIDROIT Preliminary Draft Model Law on Leasing

- **Currently**, a UNIDROIT Advisory Board is involved in the preparation of a preliminary model law on leasing with developing countries in mind. The Advisory Board is comprised of eminent leasing lawyers around the world:– U.S.A (drafters of Article 2A U.S. Uniform Commercial Code), Tunisia, Nigeria, France, Columbia, U.S. Equipment Leasing Association – “ELA”), International Finance Corporation etc., represented
- **Philosophy** – Leasing is a powerful economic tool for both developing and developed countries alike; harmonization of leasing laws required in order to facilitate greater capital investment.
- **The process**: Advisory Board prepared the preliminary draft model law, the draft has to be approved before formal adoption. Once adopted, it will be a “model law”, and can and will need to be adapted to local needs and conditions.

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# Does a Country Need A Leasing Law? Continued

This question is particularly relevant in common law countries. The answer depends on various factors.

## Arguments Against a leasing law:-

- Leasing is a contractual arrangement; and can be defined under contract terms.
- The absence of a law provides greater flexibility to parties to structure lease deals.
- Common law/ case law should provide the legal framework for leasing. Refer the case of India.

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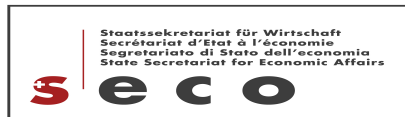


# Does a Country Need A Leasing Law?

## Arguments For a leasing law:

- Legislation/ legislative guidance provides certainty & clarity for lease transactions/ parties. Compare United Kingdom experience, and the practical experiences in Tanzania.
- Countries with no law require a strong judiciary knowledgeable and sympathetic to financial leasing and to financiers; adherence to common law principles – Compare India.
- Economic and policy considerations – Economic benefits of leasing and appropriate investment climate for both local and foreign investment for leasing.

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## Does a Country Need A Leasing Law? Continued.

- Some common law countries with codified leasing law/s: United States, Ghana, Srilanka, Egypt. United Kingdom has a legislative framework (various legislation relevant to leasing)
- Other common law countries in the process of reviewing or enacting laws: –Uganda, Nigeria, Tanzania.
- Non – common law countries: – China, Central Asia Republics (Uzbekistan, Kazakhstan), Ukraine, Ethiopia, France, Brazil, among others.

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# Legal Implications of Financial Leasing



A finance lease transaction raises the following legal issues:

- **Finance leasing is a financing transaction.**

The leasing company/ lessor is a financial intermediary supplying finance through a lease agreement. The lessor in FL is not responsible for quality and fitness for purpose of leased equipment.

‘Hell or high water clauses.’ A lease agreement between lessor and lessee becomes irrevocable once signed. **Logic:** Financial leasing is a financing arrangement equivalent to a term loan. Lessor’s paramount right is to receive lease rental payments.

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## Legal Implications of Financial Leasing, Continued.

- **Rights and duties of parties; (Legal) allocation of financial risk.**

A finance lease as a tripartite arrangement: (a) Equipment vendor/ supplier; (b) Leasing company (independent lessor/ bank department/ bank subsidiary/ captive lessor); and (c') lessee.

Equipment quality claims (defects) must be addressed directly to the vendor. Lessor will avoid equipment claims. Right of lessee to direct equipment quality claims to supplier directly should be clear.

Lessor's primary duty to the lessee is of 'quiet enjoyment' of the leased property.

(Disputes of the above nature in the Tanzanian legal system).

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## Legal Implications of Financial Leasing, continued.

Lessor can assign the lease agreement – transferability promotes growth of financial markets.

Lessee should not create rights in favour of third parties without lessor's consent, e.g. subleasing.

- **Third party liability & Insurance**

Third party injury and death arising from use of leased assets.

Occurrence of damage to leased assets.

Insurance of leased assets, and loss payee.

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## Legal Implications of Financial Leasing, Continued

- **Registration of interests in leased assets**

Lessor's assertion of legal title.

Constructive notice to third party purchasers, mortgagees, pledgees etc.

Notification of assets under lease may be done with - in Tanzania with Registrar of Documents/ Titles - Chattels Transfer Act.

- **Enforcement of lease contracts and repossession of leased assets**

Efficient mechanisms for recovery of leased assets and financier's investment required, where lessees default on lease payments. Summary Procedure should be available under Tanzania Civil Procedure Code Act, 1966 for recovery of debts arising from finance lease agreements.



# Prudential Guidelines for leasing companies

- **Prudential guidelines** are required for Banks, Financial, and other deposit taking institutions that carry on the business of leasing.
- Although there is usually limited justification for guidelines for non – deposit taking institutions carrying out leasing operations. Capital adequacy requirements, corporate governance and light regulation for **non – deposit taking leasing companies** may be necessary dependant on the level of a country's development. There are advantages and disadvantages of regulation for these types.
- **Existing Guidelines for Banks:**
  - Investment in moveable property
  - Concentration of credit
  - Debt/ equity ratio
  - Capital adequacy requirements

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# Prudential Guidelines for leasing companies



## **Objectives of Central Bank Supervision:**

- To protect public from undue harm.
- Promote confidence in the financial system.
- Promote the role of the financial system towards economic development.
- Prevent public finances being hit by a major financial crisis.

## **Purpose of regulation of leasing companies:**

- Prevent mortality of leasing companies.
- Avoid damages to creditors and funding sources to leasing companies.
- Avoid damages to lessees, and suppliers.
- Require accountability from shareholders, directors and managers.

# Prudential Guidelines for leasing companies

## Important issues to consider:

Matching Assets and liabilities maturities

Matching Exposure to exchange rate fluctuations

Matching exposure to interest rate fluctuations

(All of the above are considered by BASEL as Market Risks).

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## Lease Documentation:

- **Master Lease Agreement**

Allows for leasing of goods from time to time.

Contains principal provisions (terms & conditions), pursuant to which all business between lessor and lessee can be conducted.

- **Lease Agreement**

Can be used where a Master Lease is not required.

May ordinarily contain provisions such as: subject matter of lease, rent, delivery and operation of goods, payment, notification, and reporting, maintenance, insurance, default and remedies for default, assignment, hell or high water, disclaimer provisions, early termination, purchase option.

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# Lease Documentation

- **Finance Lease Schedule**

Financial terms including, advance rentals if any, lessors capitalized costs, basic term, basic term commencement date, taxes, option payment etc.

- **Maintenance Agreement**

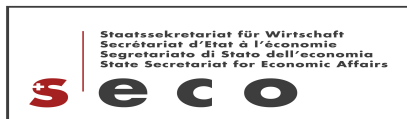
Between lessee and third party manufacturer, supplier or dealer or other party providing maintenance services.

Specifies terms and conditions by which assets are maintained.

Assets maintained from time to time based on usage or after periodic intervals.

Maintenance charge may be fixed or variable.

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# Lease Documentation

- **Buy – Back Guarantee**

Usually between lessor and third party manufacturer providing the buy-back guarantee.

Lessor requires vendor to repurchase the asset at a determined price or price ascertained at a certain formula.

- **Other Documents – Landlord's Waiver, Lender's Waiver, Agency Agreement, Personal Guarantees.**

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## Lease Documentation

- **Landlord's Waiver**

A Landlord's Waiver is required where a lessee leases goods from a lessor, and the goods are affixed to immovable property that belongs to a third party, the landlord. The landlord in this case should provide a waiver that as long as the goods are under financial lease, the leased property shall not become part of the land, and that the landlord shall not have any rights to the same.

- **Lender's Waiver**

This may be required where the lessee is a corporate entity that has issued debentures which charge the company's property to other third party lenders. A lessor of goods for financial lease may require the lessee company (to which it leases goods) to obtain a Waiver from those other lenders that the property under finance lease shall not form part of the Company's assets. These are useful instruments in countries where movable asset registries are underdeveloped/ inefficient. By obtaining a Lenders Waiver a lessor will effectively ring fence/ isolate the leased assets from the pool of company asset.

# Lease Documentation

- **Personal Guarantees:**

Leasing companies in less developed leasing markets may require additional security for a finance lease. In these markets, it is common for leasing companies to require the lessee to provide a personal guarantee made by a third party in respect of the finance lease agreement. The Guarantor, under a Guarantee Agreement, will guarantee to the lessor payment of outstanding lease payments in event of the lessees' default on the finance lease.

The personal guarantee should be backed by realizable property/ assets

- **Agency Agreement**

This Agreement may be necessary if the Lessor wishes to appoint the Lessee his agent for the purchase of goods from the vendor, and if the lessor does not wish his identity known.



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# Thank you

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