LECTURE No.6

FACTORING

The beginnings of factoring

The first market for factoring was in the United States of America where from the early 1890s factors started to offer their services to clients active in textile and clothing sector. Until the 1960s American companies were primarily family owned. But when banks were given the authorization to engage in factoring, a string of acquisition took place. Today, nearly all of the major American factors are bank owned, and factoring has become more accepted and respected as an integral part of the financial sector.

As ownership of the American factors passed to the banks, factoring began to go overseas. American know-how was first introduced to the United Kingdom in the 1960s, and similar initiatives followed later in other Western European countries. Some companies were joint ventures with large American factors, while others were independent initiatives taken by local commercial banks with a keen eye for the attractiveness of receivables financing on a factoring *basis*.

At a diplomatic conference in Ottawa in May 1988 the International Institute for the Unification of Private Law in Rome (commonly known as UNIDROIT) presented "…*uniform rules to provide a legal framework that will facilitate international factoring*…". The full text of their definition contained in Article 1.2 and 1.3 is as follows:

2. for the purposes of this Convention, ***factoring contract*** *means a contract concluded between one party (the supplier) and another party (the factor) pursuant to which:*

- *(a) The supplier may or will assign to the factor receivables arising from contracts of sale of goods made between the supplier and its customers (debtors) other than for the sale of goods bought for their personal, family or household use;*
- *(b) The factor is to perform at least two of the following functions:*

Finance for the seller, including loans and advance payments;

Maintenance of accounts (ledger keeping) relating to the A/R;

Collection of receivables;

Protection against default in payment by the buyers;

(c) Notice of the assignment of the receivables is to be given in writing to the debtors.

3. In this Convention references to "goods" and "sale of goods" shall include services and the supply of services."

This is the official definition of factoring, internationally accepted. The definition presented by the Bank of France is based on the juridical dimension:

"A factoring operation consists in the transfer of commercial receivables from their owner to a factor, which assumes the obligation to cash them in, even in the case of a temporary or permanent incapacity of the debtor. The factor can pay in advance all, or only a part of, the total amount of the transferred receivables."

The most used definition is the British one, due to its simplicity and concision: the operation through which a company sells its 'Clients' accounts to a factor. This description of factoring can be translated into legal terms as the technique allowing a seller of goods or services to transfer his receivables towards a specialised institution, which becomes their owner.

A factor purchases book debt of a client company, usually buying that payable within a maximum period of 180 days. Up to 80 % of the invoice value is paid to the Client Company immediately, the remainder, net of fees and expenses, is paid after the debts have been cleared.

The implementation of factors (credit institutions) was determined by the supplier's need to cash in the amounts from his debtors as soon as possible and to be exempted from keeping track of the debtors, or from pursuing them in case of non-payment. The factor will take on him the duty of cashing in the client's receivables, becoming their beneficiary. At the same time, he assumes the whole risk of non-payment by the debtors[1].

The main types of factoring are:

1) The full service

Factoring in its full form, or old line (i.e. traditional) factoring, is a continuing relationship between a factor and a supplier (the client) of goods and services to trade customers in which the factor purchases substantially all the trade debts of his client arising from such sales of goods or the provision of such services as they arise in the normal course of business.

The client in return for agreed fees and finance charges is thereby relieved:

- From the need to administer and control a sales ledger and collect amounts payable from the debtors;
- From losses arising from the inability of a debtor to pay;
- From the provision of trade credit to the debtors, to a substantial degree.

The transfer of ownership of the debts is normally accompanied by the submission to the factor of the copies of invoices that represent the debts sold. In some cases, the factor may require the submission of originals to him for onward transmission to the debtors, accompanied by copies for retention by the factor. Many factors now arrange for their larger clients to notify debts to them by electronic means and some do not even insist on the input to be supported by hard copies of invoices or credit notes.

The factor, in turn, is responsible to the client for the purchase price of the debts assigned. The purchase price is normally the amount of any discount or other allowance allowed to the debtor and, in some cases, after the deduction of the factor's charges. The factor will credit the account of the client in his records with such purchase price of debts sold and as a corollary the client may charge all his sales to one account – that of the factor. The client will now look to the factor alone to collect the proceeds of his sales.

The final date for payment of the purchase price will be either a fixed number of days after invoice date (often referred to as *the maturity date*) or when collection has been effected from the debtor.

To the extent that the factor has given approval of the debts, he purchases the debts without recourse to the client as regards the debtor's failure to pay owing to insolvency. The client thus receives full protection against bad debts provided that he does not sell to any debtor not approved by the factor or to an extent greater than the approval given.

By making an early payment (sometimes referred to as *prepayment* or an *initial payment*) on account of a substantial part of the purchase price of each debt as soon as it is created and purchased, the factor provides the finance to meet the trade credit requirements of the client's debtors. Some factors make such prepayment by way of an advance secured by their right to set it off against the full purchase price when due, whereas others provide for prepayments by part payments of the purchase pieces.

[1] Basno,C., Dardac,N., Floricel,C., *Monedă, credit, bănci,* Ed. Didactică şi pedagogică, Bucuresti, 1994

The factor will make a retention of part of the purchase price of each debt so that in aggregate he will hold a sufficient balance to provide for any debt to be charged back to the client by way of recourse for the non-payment of an unapproved or disputed debt. However, the balance credited for the purchase price of debts purchased less the retention may normally be drawn by the client by way of prepayment at short notice.

2) Recourse factoring

Although most forms of factoring other than the full service are provided with full recourse to the client in respect of the failure of the debtor to pay for any reason, **recourse factoring** normally describes the service by which the factor provides finance for the client and carries out the functions of sales ledger administration and collections, but does not protect the client against bad debts. The factor has full “recourse“(the right to have payment guaranteed or the debt repurchased by the client) for debts unpaid for any reason, including insolvency of the debtor.

Thus, the variation is effected by the simple expedient of providing that in respect of every debt purchased by the factor he will have the right to sell it (or part of it) back to the client for the amount for which he credited the purchase price originally in addition to his charges (or be guaranteed payment in full by the client) to the extent that the debtor shall not have settled it by an agreed period after invoice date.

The period often agreed is three months or 90 days from the end of the month in which the invoice is dated. Such a period postulates that in many trades and industries, in which the normal usage is for payment to be due at the end of the month following that of the invoice, the factor must collect payment within two months of the due date or the recourse may come into effect.

It is usual to provide that the factor will refrain from exercising his right of recourse for a specified further period in payment of an additional charge by the client. In such case, however, the factor may require that an additional retention be maintained against the purchase price of further debts purchased so that in effect the client will have repaid the amount paid by the factor against, or on account of, the purchase price of the unpaid debts.

In this way, in respect of debts that are seriously overdue, the client will remain relieved from the collection function but the finance for such debts may be withdrawn. If it becomes irrecoverable, the recourse is then finally exercised. It is apparent that the factor, in such a case, does not have the ultimate responsibility for collection. Approvals of credit are given by the factor on debtor accounts for the purpose of specifying the amount of finance available against them or as an advisory service to the client, or for both reasons.

3) Agency factoring

This variant of the service is sometimes referred to as **bulk factoring** but as virtually all factoring relates to the whole of a client's sales with the submission to the factor of batches or schedules of debts in bulk; the term "bulk" could be applied to all forms.

The term "agency" is now usually used to denote the form for which the Germans use the more descriptive term "Eigen – Service Factoring" (Own-Service Factoring). This form of factoring is further removed from the full service in that the factor, although requiring disclosure to the debtors, takes no responsibility for the administration or collection of the debts and the factoring is fully on a recourse basis.

In some cases directions are given to the debtor to pay direct to the factor; in others, although notice of the assignment is given to debtors, they are instructed to pay to the client as the factor's agent. In the latter cases the client is obliged to hold the money recovered in trust for the factor and to pay it into a bank account of the factor.

In all cases the client administers the sales ledger and enforces payment from debtors as agent for the factor; thus, this form of factoring is usually referred to as **agency factoring** or **agency discounting.** The purpose of the arrangement is purely for financing the trade credit requirements of the client's debtors and the notice to them to pay the factor is to improve the factor's security. The service provided is, therefore, no more than that obtained by means of invoice discounting, and it is sometimes referred as **disclosed invoice discounting.**

This system is used where the client's pattern of trade consists of a large number of small debtor accounts but where he does not meet the standards of financial standing or administration required for consideration of an invoice discounting arrangement. However, although the foregoing is the usual nature of agency factoring, at least one leading factoring company provides this service on a non-recourse basis, subject to approval of debtor accounts. Another recently developed variant has been described as a halfway house between recourse and agency factoring. Under that arrangement the factor retains responsibility for the administration of the sales ledger but allows the client to carry out collection procedures[2].

4) Invoice discounting or confidential factoring

For the clients who need finance for the trade credit requirements of their debtors but no administrative service or protection, another service is provided extensively by factors.

By the sample expedient of releasing the client from the need to notify the debtors to pay direct to the factor and by providing that all debts sold to the factor should be subject to full recourse, factoring is changed to a purely financial service sometimes referred to as **confidential factoring** or, more commonly, **invoice discounting**.

In the early days of invoice discounting, debts represented by individual invoices were sold to factors. This system gave rise to some difficulties: it was not always possible for the client to pass on to the factor the payment for the invoice in its original form as the payment might be made after deductions for cross-claims or combined with payment of other invoices.

In recent years, the service of invoice discounting has more usually been provided on a *whole turnover* basis by including all the client's sales or all his sales to particular customers. The client maintains the sales ledger and collects from the debtors on behalf of the factor to whom the ownership of the debts has been transferred, and arrangements are made for the proceeds of collections to be paid by the client direct to the factor's bank account.

5) Undisclosed factoring

The term **undisclosed factoring** is sometimes applied to an invoice discounting as described above; but it is usually taken to denote an arrangement for invoice discounting whereby the factor will provide protection against bad debts to a limited extent by specifying that an agreed percentage (normally 80%) of any approved indebtedness shall be without recourse as regards credit risks.

The arrangement limits the protection to such a percentage so that the client, who maintains the ledger and collects from debtors, has some incentive to carry out the duties with efficiency. In some cases however factors have been known to accept the full amounts of approved debts should be without recourse and thus to provide the same protection against bad debts as in the full service.

[2] It is referred to as CHOC (Client Handles Own Collections), for a purist a misnomer: the collections are the factors and not the client's because the debts belong to the factor!

6) Maturity factoring

The above are the principal forms of factoring in which the factor provides finance by making prepayments of part of the purchase price of the debts purchased by him.

Where finance is not required, an arrangement, used increasingly by small businesses as an alternative to credit insurance, comprises full administration of the sales ledger, collection from debtors and protection against bad debts. This service, often called maturity factoring, can be defined as a full service factoring without the financing element.

Because of the lack of financing, the guarantees are different. The risk consists only in debtors' risk; there is no seller's risk. For the same reason, there are no financing commissions, the factor being remunerated through commission taxes.

- The factor pays his client's receivables in one of the following ways:

After a certain period from the date of invoicing (the maturity period); the client knows when he receives the money, so he can his cash flow accordingly, or

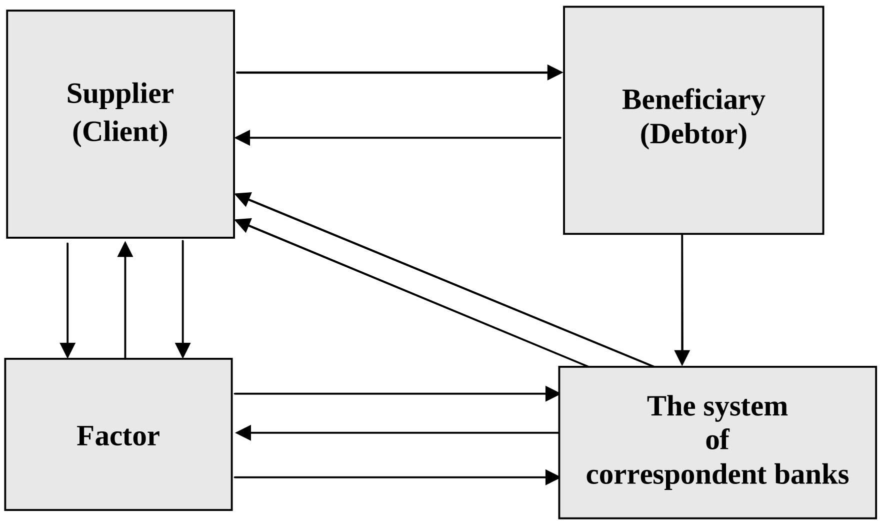
- Cashing in the receivables from the debtor, or

- In the case of the debtor's insolvency, after cashing the insurance policy, if the non-payment risk is insured.

- To apply for this service, the client is supposed to have enough finance sources; he demands the factor to improve the weak administration of his organisation, to diminish the indirect costs and to ensure security.

Basically, a factoring operation involves three participants: **the factor**, usually a banking institution buying the receivables which a business, called **the client**, has over another business, called **the debtor**. The factor represents the link between the client and the buyer, to whom it renders several services.

The mechanism



Source: Cirstea, A., *Consortiile bancare si factoringul – certitudini ale cooperarii financiar-bancare internationale,* Bucuresti, 1999

1. The supplier (client) delivers the merchandises to his domestic or foreign client (debtor), according to the commercial contract concluded between them.
2. On the basis of the factoring contract, the client presents to the factoring company a register consisting of :
   - the ceded receivables, together with their rights and accessories;
   - a declaration of transferring his receivables to the factor;
   - a payment request for the issued invoices.
3. After analyzing the invoices received from the client, the factoring company lets him know about the accepted invoices (taking into consideration the guarantees each of them provides).
4. The client sends to the factor the originals of the accepted invoices. From this moment on, it is the factor that will cash them in, and will take the potential financial risks that could appear. In his position as owner of the receivables, the factor has no right to turn against his client.
5. The client announces to his debtor the ownership transfer of his receivables to the factoring company.
6. The factoring company pays a first share of the accepted invoices' amount, usually 80 - 85% of their total value, after deducing the agio (the factoring company’s commission).

The agio differs from one country to another and from one period to another, according to the economic situation and to the relationship between demand and supply.

For its general services rendered to the client, the factoring company receives a commission, whereas for the prepayment of the invoices (before cashing them in from the buyer), it receives an interest, calculated as *pro rata temporis*.

7. The client learns from his bank (through a statement of account) about crediting his account by the corresponding amount.
8. Upon the received notification, the debtor will pay to the factoring company the entire value of the invoices on the maturity date stated in the economic contract.
9. The factor learns from his bank (through a statement account) about crediting his account by the total value of the accepted invoices.
10. Within 2-3 working days since it has cashed in the money from the debtor, the factor shall pay to the client the rest of 15-20%.
11. The client learns from his bank (through a statement account) about crediting his account by the value of the second share of the invoice value.

Companies ask for factoring in order to benefit from various advantages, such as:

- The factor takes the risk of non-payment by the external debtors and makes the payment of the receivables before their maturity, turning a ‘period-payment’ into a ‘current-payment’;
- The period for obtaining liquidities is much shorter than in the case of a credit; the client will improve his cash-flow, the money being used according to his immediate needs and not for specific destination, as in the case of a credit.

The documents needed for obtaining financing through factoring are not as many as when applying for a credit. The acceptance of receivables by the bank is irrevocable, but it implies a proper execution of the commercial contract by the client.

The import-factor can check each of the buyers from various countries where the seller exports.

The debtor (importer) pays the value of the receivables in his country, avoiding a currency exchange; at the same time, he has the opportunity of corresponding with the import-factor in his own language and of solving potential litigations within the legal framework and the jurisdictional competence which are familiar to him.

The factoring operations represents an advantageous means of financing for exporters, providing liquidities necessary to develop their business, protection against the risk of non-payment by their debtors, administration and collection of invoices, in the conditions of attractive costs.

Taking into consideration that not all activities can be performed by factoring, the clients' selection supposes an analysis of the business, a deep understanding of all the aspects involved in it, in order to make the decision whether factoring is appropriate or not.

Besides his obligation of cashing in receivables, the factor (both export and import) can offer his client two supplementary services:

1. **guarantee** for a proper execution of the contract;
2. **financing**, by making available the whole sum or a part of it, representing the invoice value, before the buyer's payment.

.3 The legal framework of factoring

The legal framework for factoring includes the Government Ordinance No.28/2006.

A factoring contract is the contract by which a person (the client) cedes his receivables to a third party (the factor), who assumes the responsibility of taking over the receivables in exchange for a tax (the agio).

The direct transfer of invoices (no other formality needed) does ceding the receivables, the factor becoming their owner.

The contract clearly and completely stipulates the rights and duties of each party.

The nature of the contract

The factoring contract has to comply with the common law regulations and it has an *intuitu personae* character. This dimension is permanently present due to its commercial operationally. Thus, the factor may cancel the contract if significant changes in the financial or juridical structure of the client occur.

The contract stipulates mutual rights duties with onerous title (as their meaning is the payment for the services rendered by the factor to his client), whose execution is consequent, according to the time distribution of the operations' phases.

The structure of the contract

The structure of the contract (see the Annex No. 1) comprises two aspects:

- general conditions (regulating the general framework of the relationship between the factor and the client);
- Particular conditions (specific provisions agreed by the parties).

The general conditions refer to:

1. the factor's duties;
2. the client's duties;
3. the conditions of the guarantee provided to the client:
   - previous agreement regarding the list of debtors and the amount of their payables;
   - at any moment, the factor may modify the guarantees (only applicable to future operations);
   - the factor becomes the owner of the ceded receivables;
   - the receivables are not contested by the debtor;
   - the guarantee does not apply over receivables not cashed in either because of fortuitous causes (war, calamities), or as an effect of financial regulations regarding the currency transfer;
4. the average period of the credit (generally, it is periodically revised);
5. the payment of the accepted receivables;
6. the subrogation (setting the conditions to achieve it);
7. the cashing in of receivables (the client shall mention on his invoices that the payment is directed towards the factor);
8. the supervision of receivables:
   - the client's obligation to pass to the factor all the receivables regarding the agreed debtors;
   - the factor's right to agree or to reject the renewals or the arrangements requested by the debtors;
   - the expenses related to the cash in operations are made by the factor (for all the accepted receivables);
9. the remuneration of the factor:
   - *the factoring general commission*, calculated on the total value of the invoice;

- *the interest* (a special commission) charged for crediting the client;
- the client's obligation to pay all *the fiscal charges* related to the execution of the contract;

10. the indivisibility of invoices and compensations;
11. the right of control for the factoring company (or a third party appointed by it) over the documents regarding the contractual operations, as well as the obligation of the client to facilitate to the factor the exercise of this right;
12. The way of solving the contests, by stating the competent body.

The particular conditions include all the specific dispositions or derogations agreed by the parties, such as:

1. the operations for which the contract is applicable;
2. the good being the object of the contract;
3. the countries to which the contract refers;
4. the maximum amount guaranteed by the factor for each debtor;
5. the average period of the credits and the revision period;
6. the maximum period for each credit;
7. the maximum payment the factor agrees to make for crediting the client;
8. guarantees and other accessories;
9. the specific conditions for the factor's remuneration;
10. the duration of the contract, which is usually undetermined, and can be cancelled by either of the parties (a notice must be made three months before);
11. the authorized risks.

A factoring contract represents:

- ***A current account convention*** intended to record all the financial glows linked with the contractual operations.
- *A payment effect* determined by the transfer of the ownership right.

In case of non-payment at maturity, the factor may choose one of the following options:

a) to cancel the crediting operation of the particular account and to debit the same account by the corresponding amount, or

b) To cancel the crediting of the account and to sue the debtors, in order to get his money back.

- *A guarantee effect*, because the receivables guarantee the debts of every party.
- *An innovating effect*, because the original receivable turns into an item of the new account, and from this moment on, all its specific actions, exceptions and guarantees end. By the effect of current account contract, the buyer does not pay the price, but places it in the credit part of the current account. Since the moment the receivable is included in this account, the seller cannot reject the sale-purchase contract anymore, because the receivable still exists only as an item of the account. Though, in case of nullity or partial cancellation of the receivable, this will affect also the recordings of the item in the account.
- *An indivisibility effect (compensation effect)*, meaning that since they're entering in the account, the receivables depersonalizes. This effect occurs only for one current account, not for two or more accounts, even if opened between the same parties (unless the explicit merger of the accounts).

- ***A convention of exclusivity***, according to which the client commits himself to deliver to only one factor the totality of the receivables he has upon all the debtors included into the contract.

The factor's attributions

According to contractual provisions, and due to the fact that he substitutes the supplier, the factor commits him to the followings (concerning the particular field of his client's activity):

1. the duty to cash in the receivables;
2. the financial risks derived from the commercial relationships between the client and the debtor;
3. updated information collection regarding the financial status of the debtor;
4. determination of the credit limit for each debtor (the client is notified about it);
5. guarantee of the receivables (together with the client) up to the established limits;
6. acceptance of the receivables for the goods included into the contract;
7. taking the position of beneficiary of the receivables;
8. performance of several operations (on the basis of the documentation), among which:
   - checking the primary financial statements;
   - accepting the documents related to the merchandises included into the contract;
   - debiting the client's account on the receivables' maturity date;

9. payment of the receivables’ value (immediately after receiving the invoices and the docket), thus becoming the client’s creditor;
10. calculation of the factoring commission and interest, deducing these amounts from the total value of receivables;
11. cashing in the invoices, keeping the necessary evidences of the debtors;
12. sending to the client periodic accounting evaluations of the debtors;
13. Starting a lawsuit against bad debtors (in case of non-payment of an invoice).

LEASING

Leasing as a modern financial technique appeared in the United States of America after the 1929 crash in order to overcome the financial difficulties. First leasing company was established in 1952 in the same country. During the 60's leasing also started to be applied in Europe and Japan.
In modern days, the leasing phenomenon in Europe appeared first in the United Kingdom in the 19th century (contract signed by the British railway Wagons)[3] – and developed in the present form over the last 30 years.

If, for some reason, a person does not wish to *purchase* an asset by means of instalment credit, that person can decide to *lease* the asset instead. By paying a rental charge over an agreed period of time a person can have the exclusive use of, say, a car as a lessee but the car belongs always to the lessor, the leasing company. Even though the vehicle is of a person’s own choice, that person has no option to purchase under a *financial lease* arrangement. At the end of the initial leasing period a person may have the option to renew at a much-reduced nominal rent. There is a second type of lease arrangement, called an *operating lease.* In this latter case, the lease is granted for an agreed term and, on expiry, the car is sold in the second –hand market to a third party. Part of the sale proceeds will be returned to you as a refund of rentals. This type of lease can be terminated voluntarily at any time if you pay agreed termination rentals.

This type of facility can improve your cash flow. Rental payments are tax deductible if you are using the car for business purposes. The lessor is responsible for maintenance of the asset, but the lessee must ensure against fire, theft and other normal business risks.

[3] British Leasing Company

Basically, *leasing* is defined as an agreement whereby the lessor conveys to the lessee, in return for a payment or series of payments, the right to use an asset for an agreed period of time.

Leasing is a financial technique that enables the utilisation of a given fixed asset without possessing its ownership.

Major parties and some brief definitions in leasing are as follows:

Lessee: The party that purchases the usage rights of the equipment in leasing transactions against the rentals determined in advance by the contract.
Lessor: The party that possesses the legal ownership of the equipment subject to leasing and that transfers the usage rights of the equipment to the Lessee against the rentals determined in advance by the contract.
The written agreement between the Lessor and the Lessee, covering all the terms and conditions in relation to the transfer of usage of the leased equipment and repayment of lease rentals to the Lessor.

Supplier: Manufacturer or marketing company providing the equipment subject to the leasing contract.

Rental: Periodical payments, effected by the Lessor to the Lessee for the utilisation of the equipment and which are determined in advance with the contract.

Leasing of goods, which are exported, operates in much the same way as the leasing of goods traded within the domestic market. The leasing company (the lessor) buys the goods outright from the supplier and then leases them to the ultimate buyer, who has the use of the goods for an agreed period, subject to payment of the agreed rent to the lessor.

The system can work in one of two ways:

- By arranging for a lessor in the exporter’s country to buy the goods and to lease them to the overseas buyer. This is known as cross border leasing; or
- By arranging for a lessor in the buyer’s country to act.

In order to summarise, it should be mentioned the two types of lease:

a) *Operating lease* – the lease term covers only part of the estimated life of the asset, which is then sold and the proceeds split.

b) *Financial lease* – covers the capital cost of the asset plus the cost of financing the lease over an agreed term. The period of rental depends on the estimated life of the asset.

Lease finance provides a significant source of funds for companies to acquire or use assets. It was estimated that leasing represented about one-eighth of the world's annual equipment financing requirement.

The purpose of the lessee could be to purchase the capital good or to solely, utilise it, for a certain period. Besides the value of the equipment, leasing provides finance for other initial costs such as: bank transfers, custom clearance, delivery, etc. incurred before the receipt of the equipment by the Lessee.

What kind of commodities can be leased?

All kinds of movable and immovable commodities and equipment can be leased. Intellectual property rights such as patent rights cannot be included in lease. The following are some examples of major equipment that can be hired through lease:

- Road vehicles;
- Construction machinery, cranes and working machines;
- Printing presses;
- Computers and high-capacity data processing units;
- Medical equipment;
- Telephone exchanges and communication equipment;
- All kinds of work benches and production machinery;
- Looms;
- Complete factories;
- Complete hospital, hotel and office equipment;
- Air-transport vehicles;

- Dry-cargo vessels, tankers and other marine vessels;
- Energy facilities, etc.

Leasing in Romania: the legal framework

In the Romanian legislation[4], the leasing operations are defined as being those operations through which "one party, called the lessor, is committed, due to the order of another party, called the lessee, to buy or take from a third party called the supplier a real estate or equipment and to transmit to the lessee the ownership or use of this good for a certain amount called payment due."

The legal framework for leasing in Romania is consisting of the provisions of the Government Ordinance No. 51/1997[5] regarding leasing operations and leasing companies and the Government Ordinance No.28/2006.

Leasing is quite new in Romania but the leasing Romanian market has developed rapidly in the last period. The number of leasing companies increased in the period 1994-2000 from 2 to more than 25.

At present, being in line with the development models on the international markets, the Romanian leasing market is structured as follows:

A. Bank affiliated leasing companies;

B. Producers or suppliers affiliated leasing companies;

C. Independent leasing companies;

The Ministry of Finance closely controls the Romanian leasing and financial leasing and cross-border transactions are submitted to a special department from the National Bank of Romania.

In Romania, all kinds of movable and immovable goods can be leased with the exception of intangible rights as copy rights and patents with maturity over one year. The law requires that the goods to be leased must be sold to the lessee and then acquired by the lessor. During the life of the lease, the lessor keeps the ownership of the leased assets, thus enjoying all the benefits associated

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[4] The Government Ordinance No. 51/1997, amended by the Law No.90/1998, and republished in 1999.
[5] Republished in Monitorul Oficial al României, Part I, No. 236/ May, 1999.

with ownership while the lessee has the right to use the assets without the interference from the lessor and the third parties.

Under the Romanian legislation, o*perating lease* is the operation settled in the leasing contract between the lessee and the lessor which stipulates that the payment of instalments for the right to use the goods for a determined period of time must cover minimum 40% from the normal life period of the goods according to the depreciation law, but not more than 80%.

The financial leasing represents the leasing operation stipulated in the contract between the financing company or leasing financing company and the user which settles the right to own the goods by the user negotiated starting with the beginning of the contract, and the total amount of the instalments paid.

The leasing operations may have as object the following: the use of the industrial equipment, the use of real estate assets with commercial or industrial destination, acquired or built by a leasing company, called real estate company for commerce and industry – SICOMI; the use of the trade fund or of one of its immaterial elements, the use of long term utilization goods of the real estate meant for dwelling, for physical persons, with the observance of the legal stipulations regarding the protection of the client.

Under the provisions of the Romanian Ordinance, the parties to a lease operation have some duties, such as:

The lessor/financier binds himself to:

a) observe the user's right to choose the supplier according to his need;
b) conclude a sale-purchase contract with the supplier appointed by the user under the conditions and terms expressly provided by him.
c) conclude the leasing contract with the user and, based on it, to transfer all the rights resulting from the sale-purchase contract, except the disposal right, to the user;
d) obey the user's optional rights consisting of the possibility to choose the extension of the contract or to acquire or deliver back the good;
e) guarantee to the user the use of the good provided that the user has complied with all the contractual clauses;
f) Insure the goods offered for leasing through an insurance company.

The lessee/user binds him to:

a) receive the good at the term stipulated in the leasing contract;

b) use the good in accordance with to contract's provisions, receive the instructions given by the supplier and provide for the training of the personnel appointed to use it;

c) not to pledge any charges on the good which is the object of the leasing, contract without having the financier's previous approvals;

d) make the payments under the title of leasing rates in the agreed upon value amount at the terms provided in the leasing contract;

e) incur the maintenance expenses and some further costs resulting from the leasing contract;

f) assume himself for the whole period of the contract, should there be no contrary stipulation, all the responsibilities resulting from the direct use of the good or from the use thereof by his officials in charge, the risk of losing, damaging or destroying the used good due accidental cases included, and to undertake to go on with the payments under the title of leasing rates till the total payment value of the leasing contract;

g) allow the financier to periodically examine the operational state and manner of the good which is the object of the leasing contract;

h) inform the financier, in due time, about any disturbance of the property right raised by any third party;

i) not to make any changes to the good without having got the financier's previous prevent;

j) deliver back the good in accordance with the previous stipulations of the leasing contract at the end of the leasing period.

In the case when the user does not fulfil his duty to pay the leasing rate for consecutive months, the financier shall have the right to cancel the leasing contract and in such case the user is obliged to deliver back the good, to pay the outstanding rates with the pertaining interest damages, the contract should not provide otherwise.

If the financier does not observe the user's option right, then the former shall pay interest – damages in an amount equal to the residual value of the thereof calculated on the expiry date of the leasing contract.

If during the leasing contract development the financier sells the good which is the object of the contract to another financier, the new financier is held liable for the same contractual responsibilities as those of the seller's and the seller remains as responsible for the fulfilment of his duties against the user.
Beginning with the conclusion date of the leasing contract and till the expiry date thereof as well as till the moment the good comes back into the financier's possession, the financier shall be exempt from any liability against the third parties for the damages caused by the user's use.

The leasing companies, being Romanian legal entities, are set up and operate in accordance with the provision of the on the business as it has been re-issued[6].

The leasing companies are business companies having as their activity object the carrying on of the leasing operations and having a minimum authorised capital of ROL 500 million, totally underwritten and paid on the setting up date.

- *For the financial leasing*, leasing rate shall be calculated taking into account the entry value and pertaining leasing interest spread – out during the period of the contract development; the purchases of the fixed assets are dealt with as investments and they are subject to amortisation in accordance with the standard regulations in force;
- *For the operating leasing*, the leasing rate shall be calculated taking into account the entry value of the good, the benefit agreed upon between the parties and the amortisation of a share from the entry value thereof; the amortisation conditions will be mutually agreed upon by the parties in accordance with the provisions of the Act No. 15/1994 on the amortisation of the locked[7] – up capital in corporeal assets, as subsequently amended.

The main types of goods leased in Romania are: vehicles and trucks - from 50% to 85%, industrial, medical and office equipment from 10% to 20%, agriculture equipment. The duration of the contract is from 10 to 60 months, financial and operational leasing.

Even if in the developed countries almost 30% of the investments are realized through leasing, in Romania this figure is not significant because the legal frame work came to regulate the operations with the last provisions in 1999. Leasing offers longer-term financial opportunities while

[6] Republished in Monitorul Oficial al României, Part I, No. 33/1998.
[7] Published in Monitorul Oficial al României , Part I, No. 80/1994.

eliminating loan problems. All the advantages make leasing a financial tool, which shall be preferred in time.

The importance of leasing

The leasing proved to be the most efficient way of financing the production investments, offering a bigger safety to the owner of the capital. All the states encouraged the financing through leasing of several investments of a general interest.

Using leasing means the appearance of advantages and disadvantages to the lessor, as well as to the lessee.

Leasing regarded from the lessor's point of view

The main advantages to the lessor are:

1. The financing of all the expenses determined by the acquisition of the equipment leased is borne by the lessee. This fact determines a low initial expense for acquiring new modern equipment.
2. The leasing is a perfect alternative for the acquisition of high quality equipment considering the fact that its technological development is extremely fast.
3. The leasing process approval is relatively short and the policy of the leasing companies concerning the guarantees is very flexible.
4. The equipment rented or the liabilities resulted from the payment of the lease fee do not change the balance sheet of the company; the fee is considered an expense and, not an investment.
5. The fixed fee facilitates a stricter expense schedule.
6. Important savings are realized in a short period.
7. The lessor allows the use of the equipment for larger fees after the contractual period expires.

The main disadvantages to the lessor are:

1. It is efficient only if the equipment is used during the entire period of the lease.
2. In the case when the lessee can attain profitable preferential credit, leasing may be more expensive. Therefore the option in favour of leasing can only be justified if the available amounts are used for more profitable investments.

3. The lessee has only the rights of use during the leasing contract period; as a result he can not alienate or sell the equipment.

Leasing regarded from the lessee’s point of view

The main advantages to the lessee are:

1. It promotes the development of exports; the supplier has the possibility to realize besides the normal export, the leasing one. The leasing export contributes to the development of the demand for high-valued goods.
2. New beneficiaries are attracted to invest. In addition, leasing has a promotional effect in the case when the equipment is rented first, the beneficiary is convinced of its yield and in the case of positive result he will acquire it.

The main disadvantages to the lessee are:

1. It transfers only the use of the equipment, not the property. Thus, as a result, the beneficiary may deteriorate the equipment and the lessor is not able to put the penalties into operation even they are foreseen by the contract.
2. After the first lease period, the lessor may not find other lessee.