<u>WHAT A LAW ON FINANCIAL LEASING HOPES TO ACHIEVE IN TANZANIA</u>

*By Moyo Violet Ndonde, Operations Officer, IFC/SECO – Tanzania Leasing Project (“**TANZALEP**”)*

For sometime now the correlation between financial leasing, capital investment and economic growth has been established. The conclusion is that capital investment stimulates economic growth. In turn, financial leasing stimulates capital investment in countries where it is well developed, for leasing enables businesses and even governments (e.g. local governments), to acquire capital assets for production. The acquisition and use of productive assets leads to productivity, income generation as well as job creation.

Financial leasing is a financing mechanism that enables enterprises (especially Small and Medium Enterprises - SMEs) procure capital and high cost equipment. Enterprises do this through the use of a financial intermediary (“financier”), such as a Bank or an independent leasing company. An enterprise will usually identify the equipment required for its business, as well as the supplier of such equipment. The enterprise will then request/apply to a leasing company/Bank to make direct and upfront payment to the supplier for the cost of equipment, plus applicable taxes, if any. Upon agreement, the leasing company/Bank will pay the equipment supplier the full cost of equipment, and take legal ownership of (‘title to’) the equipment. By way of a lease agreement with the enterprise (‘lessee’), the leasing company/Bank will lease the equipment to the enterprise for a determined period of time, for example 2, 3, or 4 years in exchange for monthly rental payments, or payments as otherwise agreed. The leasing company / Bank expects that at the end of the lease period, it will have recovered from the enterprise lessee the cost of equipment financed plus interest (i.e. finance charge or profit). The enterprise through leasing is able to use the equipment for production, and at the same time generate income to honor the monthly rental payments to the leasing company/ Bank.

Based on real life economic conditions that Tanzania faces today, financial leasing can have significant economic and developmental impacts for the country. For instance, financial leasing can propel investment in agriculture (irrigation farming), energy production, mining, and transportation. Equipment that can be financed through financial leasing includes plant and machinery, motor vehicles, aircraft, construction, power, irrigation, and other types of agricultural equipment. In Tanzania the financing of these kinds of equipment is critical to propel the country’s economic development.

Due to historical, social, and economic reasons most developing countries including Tanzania, lack appropriate legal framework for financial leasing. This is because in most cases, the legal framework tends to be inadequate to support growth of the leasing industry; to encourage leasing investment (whether local or foreign); as well as to provide certainty to leasing stakeholders –that is to say, equipment suppliers and dealerships, investors, financial leasing companies, (including banks), as well as to lessees. The legal framework for leasing in Tanzania is likewise inadequate for these purposes.

A legal framework for financial leasing may take the form of an independent “financial leasing law/ leasing law” or can be scattered across several different legislation that are relevant to the leasing transaction. A legal framework can also be in the form of authoritative judgments of a country’s superior courts, such as the Court of Appeal or High Court of Tanzania.

However, based on experiences elsewhere, as well as realities on the ground in Tanzania, it is thought that enactment of an independent leasing law will be more efficient, to stimulate capital investment in the country; to enable growth and development of the leasing sector, to provide legal certainty for financial leasing operations; and to promote much needed investor confidence in leasing. In this context, the International Finance Corporation's - Tanzania Leasing Project has recommended that the Government of Tanzania consider enactment of a leasing law.

Some of the things that an independent leasing law in Tanzania hopes to achieve are:

To distinguish financial leasing from other types of property transactions unsuited to procurement of capital equipment and business assets. Financial leasing is considered both a financing and investment transaction, and a law on leasing provides for the unique nature of financial leasing.

A leasing law hopes to provide clarity on rights and responsibilities ('duties and obligations') of parties to financial leasing. In Tanzania, the experience has been that the rights and duties of parties in financial leasing are unclear and have led to undesirable results for parties concerned, especially financiers. The underlying purpose of defining with clarity, the rights and obligation of parties, is in order that financial risk in financial leasing be duly allocated amongst the parties. For instance, who should bear the risk of defective equipment, and under what circumstances? Which party in a financial lease should give assurances regarding the equipment, and to which party should these assurances be given? Can the lessee be interrupted in its use of equipment while honoring the terms of the lease agreement? If not, who should bear the losses that arise? Which party should be responsible for injury to third parties arising from use of leased equipment, and under what circumstances? These are some of the financial risks that are inherent in financial leasing, and which a leasing law attempts to allocate through definition of rights and duties. In Tanzania some of the aforementioned issues have been or are currently in dispute in the judicial system

In leasing, the asset that a leasing company agrees to finance may be central to recovery of that leasing company's investment. A law therefore hopes to provide for efficient methods of repossessing leased assets. Financial leasing being a financing mechanism, in which a leasing company/ Bank should assume normal credit risk and not risks associated with the asset ('asset risks'), and in which a leasing company takes legal title/ ownership of leased assets, requires efficient methods of repossessing assets where lessees default on agreed payments. In financial leasing, an enterprise lessee does not acquire title to leased assets until such time that the leasing company has recovered its full investment in the asset plus profit. In Tanzania, past experiences in repossession of leased assets had not been favorable to leasing companies/ Banks, and as a result leasing companies lost investments in leased assets.

A law in Tanzania hopes to provide a minimum legal framework for leasing, so as to stimulate leasing development and investment, but at the same time to recognize that financial leasing is a contractual arrangement (agreement) between parties, and therefore that parties should retain maximum freedom to contract. It is not the aim of a leasing law to overly restrict or prescribe for leasing as this could stagnate leasing market growth.

Lastly in this edition, a leasing law hopes to provide a minimum and flexible legal framework for Tanzanian case law (on leasing) to develop. Tanzania is a country whose legal system has British common law origins, where superior courts normally pass principles of law through court judgments. However, in some common law countries such as Tanzania, for historical reasons (e.g. socialism), the application of the common law is not straightforward. A leasing law is therefore intended to provide a minimum framework that will guide superior courts in Tanzania, develop leasing legal principles where disputes are bought before these courts for determination.