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FINANCIAL SECTOR PROGRAM IN ANGOLA

LEASING AND FACTORING - ANAYLSIS OF ANGOLAN LEGISLATIVE FRAMEWORK AND DRAFT REGULATIONS

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LEASING AND FACTORING - ANAYLSIS OF ANGOLAN LEGISLATIVE FRAMEWORK AND DRAFT REGULATIONS

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PREFACE

Peter Kurz and Gary Kelly, Leasing Expert and Mission Leader and Leasing Expert, respectively, undertook a three week Mission in July 2008 to Luanda, Angola on behalf of the Financial Sector Program in Angola, an initiative sponsored by the United States Agency for International Development (USAID). The subjects of analyses were the feasibility of leasing and factoring transactions in Angola, with a focus on business and legal issues. Specifically both specialists undertook the Mission in collaboration with the Banco Nacional de Angola (BNA), with a view to advising on elaborating executive legal authority from the BNA in the form of "Avisos" on leasing and factoring. The core product reflecting the Mission analyses is captured in section I. Over the three week period, several interviews and meetings occurred. Meetings generally touched all echelons of the current financial community in Angola, including the industrial sector and key offices of government, in addition to the BNA. The Mission simultaneously engaged the large question of application of international standards for leasing and factoring. In this vein, the Mission employed several texts, emanating from both inside and outside Angola, and speaking authoritatively on business and legal issues. These are set forth in the Appendix.

The immediate product of the Mission is a summation of several main points that will contribute to the development of leasing and factoring that will be put place as early as August, 2008. To this end, the Mission focused on the most pressing issues to assist in the development of this product. It is expected that the subject of leasing and factoring will soon summon a broader public audience in Angola, both in the government and the private sector. It is also expected that the Mission product will generate wide discussion and further local analyses than the three-week Mission would allow. To this end, it is hoped that this Mission Report paves the way towards to a major acceleration of leasing and factoring

I. OVERVIEW OF LEASING, FACTORING AND THE LEGAL AND REGULATORY SYSTEM

International Standards in Context

Before setting forth a precise analyses and recommendations, the Mission finds it helpful to briefly address the relation of the legal environment to the feasibility of leasing and factoring transactions in Angola. This is **not** especially because of any peculiarities in Angolan law or regulation. Rather, it is because of the manner in which leasing and factoring progress in transitional economies generally.

Countries with a tradition of liberal, market oriented economic policies feature an environment that is largely product-driven. The legal regime then follows. Hence, it is no accident that there is a coincidence between liberal economic policies and countries with legal systems that are "bottom up" for examining the particularities of transactions as the basis for commercial law, as opposed to imposing a set of fixed legal principles on commercial communities. Such countries are predominantly common law countries in which much of the commercial law is determined by careful judicial review of the facts of particular business transactions. Such countries may be very advanced economically as are Anglo-Saxon jurisdictions, may be in transition as are common law regimes in Africa, or, like India, may feature both economic profiles. While such countries tend to be transaction based in emphasis, civil code countries, of course, rely on the force of transparent and interwoven commercial principles to classify and analyze the legal implications of new financial products and transactions.

These differences and others have had significant impact on the evolution of "international standards" for leasing and factoring. This evolution very much illustrates differences in approach and the relation of a legal system to market forces. To this day, even international specialists entrusted with the development of common standards concede that there are differences of approach even in attempting to define so basic a concept as "finance leasing." (See Castillo-Triana, Introduction of the UNIDROIT Model Law on

Leasing, 15 [cited later as Castillo-Triana]). Leasing especially flourished in the 1960s and 1970s in developed countries. Yet, it was not until the early 1990s that the United States began formulating uniform legal principles governing leasing transactions in particular. This attests to the tendency of common law countries like the United States to first let the market evolve, and then enunciate legal principles. Yet, even experts outside the United States acknowledge the importance of developments in the United States in shaping legal regimes to the realities of leasing internationally, including its adaptation in civil law countries. (See A Summary, Uniform Commercial Code Article 2A Amendments [1990] [cited as A Summary, UCC]; Castillo-Triana, 7).

All of this is to say that in searching for standards, it makes little sense to speak of a "common law" model or a "continental" model. Instead of focusing on how given legal systems resolve particular problems, it makes far more sense to look at international standards as evolving along three main themes, reflecting the relationship of any legal system to market forces:

1. **Transactional focus** – as noted, the legal system of the United States for leasing, in particular, evolved some thirty years after significant market activity was initiated. And even then, legal reform centered on such issues that would be identified at the level of the business transaction, such as the assignment of lease rights. (See A Summary, UCC). The general tendency has been to rely of the flexible standards set by judge-made commercial law. Nor has this approach been limited to developed Anglo-Saxon countries. Reliance on flexible principles of common law and some guidance from minimal legislation has fuelled a leasing boom in India over the past quarter century. One of the advantages of a transaction based approach is the development of a "cottage industry" of specialty firms engaged only in leasing, a tendency that has fuelled the leasing boom in South Asia. (See Vinoud Kathari, Lease Financing and Hire Purchase, Chapters 12-15 [cited as Kathari]).

2. **Institutional approach** – this is in marked contrast to the transactional approach. This approach assumes that leasing must be the product of public sector initiative, notably government laws and regulations. This approach may be entirely logical in countries that do not have a tradition of financial markets, notably developing countries. Perhaps the most appropriate example for Angola is Brazil. As recently as the 1990s, following the intense scrutiny of leasing by American jurists, the Central Bank of Brazil formulated legal authority that mandated institutional change in regulated banks to accommodate leasing. The executive authority from the Central bank called for "technical" departments in Brazil's commercial departments to specialize in the transaction and called for tight executive control of such departments. (See Ordinance, 2309, Central Bank of Brazil [1996]). The tendency to control market forces continued with, for example, provisions dictating appropriate leasing transactions for "universal" banks and specific exclusive definitions of operating and finance leases. Articles 5, 16-18. (See Ordinance, 2309, Central Bank of Brazil [1996]). The institutional approach has merit in countries without a significant market history of leasing, **provided that there is sufficient investment in building the capacities of regulators and public offices to effectively monitor and encourage the transaction**.

3. **Prescriptive approach** – this approach lies in between the transactional and institutional approaches. It effectively balances the importance of market forces and public institutions. Perhaps China offers the most prominent example of this balancing. China has effectively codified market practice. China's Economic law does not offer a definition of leasing in a single article. Rather, its leasing law consists of a litany of various aspects of finance leasing, such as lessee control of purchase of the property subject to lease, and the issue of title. (See Economic Law of China, Articles 212 et seq. [1996]). In other countries, the approach might be more appropriate to executive regulations rather than to general legislation. However, the Chinese codification of market practice offers the advantage of broadcasting to the general public as to business practices. In addition to China, the Russian Federation adopts roughly the same approach.

Given this summary of trends and standards, what should Angola do? **In setting forth the above classifications, regulators at the BNA should understand them as three trends that explain the evolution of international standards. The three trends represent needed perspectives, not choices.** Collectively, they point to the need to understand the reasons for legal provisions and accepted business practices, as opposed to simply focusing on the text of a law or a leasing contract.

In particular, the BNA is discouraged from "wholesale" importation of laws and regulations from a given country simply because that country is economically prosperous, or shares a social history or legal system with Angola. Similarly, in each of the above classifications, oversimplification is to be avoided. The United States did wait to formulate precise laws and regulations – yet these laws and regulations formulate a significant part of international leasing practices, even in the eyes of civil law jurists. (See Castillo-Triana, 26). The United States is thus a part of the prescriptive and even institutional trends. Brazil's institutional approach emanated from its Central Bank, yet active leasing transactions were ongoing prior to 1996. Brazil thus might be said to be a part of the transactional trend. The United States is said to lead the way to international standards, yet the Russian Federation incorporates the UNIDROIT standard in the text of its substantive leasing law, whereas the United States does not. (Compare Article 10 of the Federal Law on Leasing [Russian Federation] with Article 2A, Uniform Commercial Code).

Consideration of international standards is especially complicated when leasing and factoring are considered together. Let there be no mistaking – both leasing and factoring are critical financing tools for moving a transitional economy forward. However, under international practices, whereas leasing entails careful articulation in legal terms, factoring is a form of financing that largely rests on business judgment. Leasing is, of its nature, somewhat complicated because the lessor usually retains legal title to the leased property, and the lessee's future interest often rests on an option to purchase the property. Distinctions must be drawn between leasing and renting on one hand and leasing and conditional sales agreements on the other. These distinctions are legal. Factoring, in contrast, is a business arrangement. In factoring, a seller of obligations to a factor does so to secure an immediate but less than full recovery on monies owing, as the factor discounts this amount and collects monies due. Factoring depends less on specific legal protections peculiar to the transaction and more on the overall commercial law environment, such as that for security interests that protect the rights of seller and factor under law and a law of agency that clearly defines the relation of the factor to the seller. Therefore, international standards for leasing are thus directly derivative of the law, those for factoring on international banking practice.

None of this is to say that there are not international standards for either leasing or factoring. It is, rather, to say that countries need to be especially careful in understanding the context and reason for the standard. This is particularly true for Angola. For example, each of the three trends above is defined along the continuum of market forces versus government intervention. However, the Mission confirmed that there has been very little if any leasing done in Angola, as defined under the most flexible international standards. Nor has there been any reason for government intervention.

The initiative of the BNA to regulate in the area of leasing is therefore bold. This being the case, how should Angola implement international standards? An examination of the particulars of the Angolan case is in order.

Implementation of International Standards in Angola

Implementation of international standards as to leasing and factoring in Angola must be done with considerable care. This is not because there is little potential to do leasing or factoring transactions. Rather, it is because there is great potential for doing so and because it is imperative that the BNA, as regulator, articulate with precision, yet allow the flexibility that will permit the introduction of international practices at the same time.

The current initiative in Angola is ripe for new forms of financing, including leasing and factoring. The three week Mission encompassed all echelons of Angola's economy. Meetings and presentations the weeks of July 7, 14, and 21, presented the opportunity to interact with key stakeholders representing a cross-section of interests in Angola's economy. Discussions encompassed representatives of banks of different sizes and philosophies, both individually and in association, meetings with major suppliers to the agricultural sector, European educated and Eurocentric executives in the financial sector, Chinese exporters to the Angolan consumer and business, government officials providing the webbing for Angola's "safety net" to regions outside Luanda, government revenue agents and economists, and of course, the BNA.

While a passing glance at Angola might lead to the conclusion that factoring, and especially leasing, are a *tabula rasa*, or "blank slate" in Angola, the situation is much more complicated. It poses great potential for taking advantage of opportunities, so long as the equally large possibility of pitfalls is understood – and avoided. To see this, we take a brief "readiness assessment" for leasing and factoring in Angola, using the following three criteria:

- **Public laws** – parliamentary laws are the most definitive and public products of state policy. Yet, at present, Angolan laws on the subject of leasing and factoring are in a state of ambiguity. The Civil Code, arguably the "economic constitution" of the country, devotes an entire chapter to "locacao." (See Articles 1022-1118, Civil Code). This includes specific reference to industrial and commercial leasing. However, the mechanics of these articles treat the transaction as if it is mere short term renting, with no distinction between renting and leasing. In contrast, Articles 4-5 of the Law "On Financial Institutions" speaks of leasing and factoring as specific commercial endeavors, being so explicit in Article 2, as to link the terms with specialized non-bank financial institutions. This hints at the institutional approach used by Brazil and described supra. However, even this apparent attempt to focus on leasing and factoring as specific transactions has flaws. The law refers to leasing and factoring principally as aspects of particular specialized institutions. This approach is to the detriment of a clear statement in the law as to the nature of the transaction. Fortunately, Articles 4.2 and 6.2 of the law give the BNA the authority to correct this inadequacy.

- **The commercial audience** – interviews and meetings the weeks of July 7 and 14 suggest that there are at least two commercial audiences for leasing and factoring. One is quite vocal and generally well-informed. This is the audience of internationally oriented banks, whose executives in Angola at least know leasing and factoring in a derivative sense, through the activities of their institutions outside Angola. Interviews and meetings suggest that the clients of such institutions in Angola will likely have economic resources and will have been well vetted already for creditworthiness before leasing or factoring would be undertaken. Such Angola clients will learn the potential value of leasing and factoring as tools from these banks. Meanwhile, there is a silent audience for leasing and factoring. This is Angola's economic community at the level of small to medium businesses (SMEs), including business "start ups" in the construction and agriculture sectors. The theoretical possibility of 100% financing through leasing has been heralded as a prime benefit of the transaction. (See The Conference Board, Leasing in Industry, 9-12 [cited as the Conference Board]). It is one from which the SME echelon especially should benefit. Here, it is to be noted that USAID and the BNA agree not only that the SME echelon is an important audience, but that it is the prime audience for leasing. (See The United States Agency for International Development and National Bank of Angola, Operationalizing Leasing and Factoring in Angola [cited as USAID-BNA Operationalizing in Angola]). Unfortunately, firms at the SME level infrequently relate to a bank except to make modest deposits, cannot access commercial law and, above all, cannot offer sufficient security for a loan. However, two things are needed to bring the silent audience to the transaction. First, the silent audience needs information as to the nature of leasing and factoring. Secondly, the financial community needs assurances in the law that there are appropriate means of risk control. From these

problems, there is opportunity for clarification by the BNA and opportunity to especially benefit the SMEs.

- **Public institutions** – in theory, the key front line public institutions for advocacy of leasing and factoring in Angola are: the court system, the Commercial Registry and the BNA. In theory all share a common characteristic: political neutrality and therefore the advantage of speaking with credibility. However, of the three, the BNA is by far the best candidate. In no country in the world is the court system involved in pronouncements of public polity. In any event, the courts are unlikely to have immediate impact even at a transactional level. Interviews and meetings held the weeks of July 7 and 14 suggest that sophisticated financiers will structure leasing transactions in such a manner to avoid the court system. And, the SME "end user" is highly unlikely to seek access to the courts in the event of a problem with a lessor. This is particularly the case in civil code systems where the judiciaries are highly oriented towards the formalities of title and the typical leasing transaction involves keeping title with the lessor.

There is no question as to the importance of the Commercial Registry. However, as empowered and structured, it is not responsible for property interests in industrial capital goods or for contract rights through accounts receivables and negotiable instruments. It is precisely these types of commercial property that are the grist of leasing and factoring transactions, respectively. It is, therefore unlikely that the Commercial Registry will call attention to its shortcomings in active advocacy of leasing and factoring. Like the court system, it is in need of reform to accommodate leasing and factoring. By default then, the BNA is the critical public institution to initiate reform.

But the BNA is also the institution of design. Whatever the category, law, commercial audience or public institution, the BNA has **the** crucial role in bringing international standards for leasing and factoring to Angola. But, which standards? Ambiguity with respect to all three factors noted above will require that the BNA be flexible in its articulation of standards.

Should BNA standards be American, Chinese, or perhaps Brazilian? The answer is that they should be Angolan. This means adapting to the realities set forth in this section. Its authority should borrow on all three trends in international standards as set forth above.

- **Institutional** – as responsible for issuing legal authority on leasing and factoring, the BNA will naturally be institutional, calling attention to its own authority. In doing so, it should enunciate the internationally acceptable standards for leasing and factoring correctly. Meetings and interviews held the weeks of July 7 and 14 indicate that the informational role of legal authority is vitally important to communicate to a broad audience of potential end users and financiers.
- **Prescriptive** – the BNA needs to assert its exclusive authority, as a public executive body, over leasing and factoring, as set forth in the Law "On Financial Institutions." The BNA has a critical role to play in correcting the less than definitive legal standards that currently exist.
- **Transactional** - no matter how carefully legal authority is drafted, the business community needs to know that its uncertainties are largely resolved. This means using legal authority to ensure, to the extent possible, that the law encourages the transaction by protecting lessor investment and minimizing risks.

The attached sections II and III set forth **Recommended Articles, Proposed Aviso Language** and ***Explanations***, for leasing and factoring, respectively, with these ends in mind.

A Note on the Overall Enabling Environment for Leasing

The immediate and dominant goal of the Mission was assistance with the Aviso. This said, the Mission developed some understanding of the challenges and opportunities for reform so as to facilitate leasing

and factoring in the intermediate and long term. Several local constituencies come into play. Among these are:

- **Parliamentary legislation** – the Aviso should provoke interest in expanded policy making to accommodate factoring and especially leasing. At the earliest opportunity, the BNA should make inquiry of the Ministry of Commerce and the Ministry of Foreign Affairs concerning Angola's status vis a vis the UNIDROIT Convention on International Financial Leasing (Ottawa, Canada, 1988), a major international initiative of the Institute for the Unification of Private Law. Perhaps Angola has been a signatory. This is an international convention that addresses nation-states as signatories. Though much of the UNIDROIT convention concerns relations among signatory states in the event of international leasing transactions, much of the convention speaks to issues of other importance, including setting forth international norms for finance leasing. Parliamentary legislation might codify such issues domestically and surely cover more issues than possible under an .
- **Internal BNA regulations** – from time to time in dealing with the BNA, the Mission heard the term "a structure of regulation" or very similar words. It should be understood that no two regulators in the world regulate leasing and factoring in the same way. This said, the will provide a good framework for the development of internal supervisory regulations handling leasing. The Mission responded to a BNA request by Memorandum of July 21, 2008, providing an outline of considerations that will be the basis for "a structure of regulation" as conceived in the BNA. Ultimately, of course, the BNA will have to decide how to most efficiently regulate in the leasing area, though the Aviso should provide some guidance here.
- **The Commercial Registry** – ideally, comprehensive reform would make the Commercial Registry applicable to all commercially viable forms of property. However, meetings held the weeks of July 7 and 21 suggest that comprehensive Commercial Registry reform will not occur in the near future. More plausible in the immediate future is innovative interpretations of the present law to expand the rights of lessors in the area of security interests. Such an expansion of the notion of security interests should take into account the reality that leasing is 100% financing, and thereby encourage would be lessors, especially as to the small to medium business sector.
- **The courts** – like the Commercial Register, prospects for significant court reform in the near term are not realistic. Banks involved in the high end of the leasing market will always avoid judicial disputes through stringent cash collateral and similar requirements. But these exclusive arrangements will do little to expand leasing in the SME sector. Nor can the SME sector rely on court relief. Thus, encouragement of leasing will rely on a liberal, expansive interpretation of the rights of lessors. This may come in the context of expanded access to "self-help" and other measures. Again, a good long term investment is preparing courts for the types of issues they may eventually face in leasing (for example, repossession disputes, calculation of damage based on amortization, etc).
- **Related professional communities** - Accounting, law and appraisal come to mind. Evidence gathered by the Mission the weeks of July 7, 14 and 21 suggests that there but a few in each profession that may know leasing and factoring practice. The BNA is encouraged to put leasing and factoring at the center of its dialogues with these professional communities. The BNA is also encouraged to monitor the evolution of accounting standards in connection with the development of commercial standards in southern Africa.

The BNA cannot accomplish every needed aspect required to accelerate leasing and factoring. But, it can stimulate multifaceted recommendations for the need for change and innovation across all three constituencies above.

II. RECOMMENDED REGULATION ON LEASING TRANSACTIONS BY THE NATIONAL BANK OF ANGOLA

Preface: The Bank of Angola (BNA) has requested assistance of the Financial Sector Program in Angola, an initiative sponsored by the United States Agency for International Development. This assistance is targeted to the development of an "Aviso" or high level decree from the BNA concerning the key legal aspects of leasing, and related concerns to facilitate an enabling environment to encourage leasing.

The background for the request is in the context of the current legal and business climate for leasing in Angola.

Neither the Civil Code of Angola, nor its Commercial Code, nor related parliamentary legislation, elaborate on the commercial aspects of leasing transactions, or address attending legal responsibilities given international standards. There is no commercial law devoted exclusively or mainly to the subject of leasing.

Instead, what elaboration Angola's parliamentary laws provide is less in the context of commercial law and more in the nature of the law on financial regulation. Specifically, Articles 4.1 g and Article 5.1 d of the "Law on Financial Institutions" grant authority to bank and non-bank financial institutions, respectively, to engage in leasing. However, discussions held the weeks of July 7, 14, and 21, 2008 confirm that, unless elaborating regulation is provided:

- -Efforts to conduct leasing would, at best, only approximate leasing as conducted pursuant to best international practices
- -Execution of leasing transactions would be of uneven quality, with some financiers borrowing from international experiences, and others having little guidance as to how to conduct leasing transactions
- -Supporting and enabling public institutions necessary to enhance leasing will not receive proper scrutiny for readiness, as only regulations can signal a proper commitment from the BNA and the national government to ensure that such institutions as courts, accountants and law enforcement officials are prepared for such transactions

The **Recommended Articles** below are designed to become key aspects of the needed Aviso. Meetings held the weeks of July 7, 14, and 21 confirm that such an Aviso should contain a clear statement of general principles and be flexible enough to last through the initial introduction of leasing products, through an intermediate implementation period of three to five years. Hence flexibility is needed. Meetings within the BNA during this period confirm that the hierarchy of legal authority issued by the BNA encourage a flexible approach; subordinate legal authority, called "directiva" and " instructivo", that elaborates on the Aviso might contain statements that could become permanent in an Aviso subsequent to the passage of five years. These subordinate forms of legal authority might also be used to set forth elaborations that could be tested as to the areas of leasing and assume increasing importance that might be the basis for future Avisos.

The leasing specialists of the USAID Financial Sector Program in Angola realize and encourage constant reconsideration of the BNA leasing and factoring initiative to ensure conformity to local realities. For this reason, the material presented below has two notable characteristics. First, to demonstrate connection of international standards and business practices, each **Recommended Article** below contains an ***Explanation***, referring to either these standards or to local considerations, notably those in Angolan law. Secondly, to promote maximum understanding in the BNA, the **Recommended Articles** are not written in formal legal language. The leasing specialists (here-in-after identified as the "Mission") have drafted

the **Recommended Articles** so that they will be easily rendered into correct formal legal style in Portuguese.

And this leads to a third component of the presentation. It is an attempt at rendering each **Recommended Article** into the approximate language of an Aviso. This has been undertaken at the request of the BNA. This rendering of approximate Aviso language appears between each **Recommended Article** and the ***Explanation***, under the title **Proposed Aviso Language**. A caution: there are very significant limitations to attempts at rendering exact wording from one language into another; this is doubly true in the area of the law where expressions are highly specialized and idiomatic. Among the limitations in the **Proposed Aviso Language** are that "exact language" drafts of legal documents can only be fully successful if:

-There is considerable expertise in the legal vocabularies of two legal cultures, in this case Anglo-Saxon and Angolan Portuguese, coupled with deep experience in the transposition of the two languages in a wide variety of contexts;

-There is intimate understanding of BNA manners of phraseology, executive legal style and related matters (covering such issues as determining the order, numbering and length of articles, manner of stating conditions and qualifications, cross-referencing legal authority outside the BNA and the like);

-There is great understanding of the interplay of the BNA technical department involved, the Supervision Department, and the Legal Department, and, indeed, the interplay between BNA and other branches of the executive structure of Angola.

Limited resources and time, did not permit the Mission to acquire any of the above capabilities necessary to make a "word for word" rendering completely successful. This means that the BNA will have to give special attention in considering the **Proposed Aviso Language** accompanying each **Recommended Article**. First, careful consultation of the **Recommended Article** and its *Explanation* is needed to ensure that the fullest meaning is captured by the **Proposed Aviso Language**. Secondly, BNA personnel are strongly encouraged to borrow on the breadth of experience represented by the Legal Department of the BNA, especially as to issues of legal vocabulary and international legal standards. Thirdly, effecting leasing means understanding economics, finance, accounting, tax policy and formal regulatory process outside the BNA. Prior to committing to the language of any single draft, including the **Proposed Aviso Language**, it is recommended that the BNA avail itself of offices of the Angolan government and the private sector generally, as to issues of vocabulary, international standards, and others connected with the subject matter.

Finally, the Mission recognizes limits imposed on the exercise below, either because of the nature of the Mission or because of limitations imposed on the BNA. As to the latter, no central bank can be completely responsible for an effective enabling environment for leasing. This requires an efficient and fully responsive commercial court system, transparent procedures for registration of ownership and security interests in all commercial property, operating credit reporting agencies, and accounting and legal professions that widely understand these transactions. It is hoped that the **Recommended Articles** below become a basis for a BNA Aviso that will spur entities in Angola, both in and out of government, to promote leasing. The **Recommended Articles** were phrased very much with existing limitations in mind. Secondly, the treatment below does not deal with immovable property subject to leasing. This is because of an understanding reached between USAID and the BNA, prior to the Mission, that the complicated and highly specialized field of real estate would be left outside the tasks of the three week Mission.

Because the **Recommended Articles,** the **Proposed Aviso Language** and *Explanations* were formulated after careful consideration, it is highly advisable that they remain together at all stages of the evaluation process, both inside and outside the BNA. Because leasing is an exceptional commercial transaction

everywhere, it is highly unlikely that any **Recommended Article,** and its companion **Proposed Aviso Language,** will be appreciated without its *Explanation*. Also, the **Recommended Articles** and *Explanations* should be a familiar format to any lawyer from a civil code country. The *Explanations* are, in effect, like expert jurist commentary on any given proposed article of a code. The Mission understands that the BNA may have a format of analysis that departs from this more legal presentation. Since the Aviso is a legal product, it is highly advisable that any draft from the **Recommended Articles** and the **Proposed Aviso Language** first appear in draft form as a legal product. Thereafter, non-legal constituents within or outside the BNA may reduce it to any template they choose to facilitate their evaluation.

Analyses proceed below.

Recommended Article #1: This Article will provide that a leasing transaction is one in which the lessee undertakes to make regular payments to a lessor in return for the possession and use of identified property, while the lessor retains such title and ownership as may legally exist in such property, with the intent, as clearly expressed in the contract of lease, that the lessee's possession and use approximately or substantially coincide with the useful life of the leased property.

***Proposed Aviso Language (Article #1)**: A leasing transaction is one in which the lessee undertakes to make regular payments to a lessor in return for the possession and use of identified property, while the lessor retains such title and ownership as may legally exist in such property, with the intent, as clearly expressed in the contract of lease, that the lessee's possession and use approximately or substantially coincide with the useful life of the leased property.*

Explanation #1: The above **Recommended Article** contains elements of the Unidroit Convention on Financial Leasing of May, 1988 (UNIDROIT). The **Recommended Article** does emphasize possession and use rather than title. This is consonant with international standards under UNIDROIT. At the same time, the **Recommended Article** recognizes the need for clear standards between mere renting and leasing, on one hand, and between a conditional sale and leasing on the other. Unlike leasing under the **Recommended Article**, renting does not commit use and possession to the lessee for a substantial part of the economic life of the leased property; unlike a conditional sale arrangement, title does not pass to the lessee. This need for delineation is especially acute in a jurisdiction like Angola that has a limited history with leasing and where definitive evidence of formal title to property, as a practical matter, remains in flux due to a less than comprehensive Commercial Registry and other factors. The above **Recommended Article** represents a compromise, reflecting as it does the reality that the lessor is likely to retain formal legal interest, yet in a context in which use and possession for nearly all or all of the economic life of the leased property are the central element in the lease. The definition of leasing above is broad enough to encompass both finance and operating leases, the distinction between which, under international standards, is discussed *below*.

Finally, during meetings the weeks of July 7 and 14, members of the BNA raised the quite legitimate issue that Article 2 of the Law on Financial Institutions already defines leasing activities in the context of defining leasing companies. Thus, there was some issue as to whether the **Recommended Article** was a redundancy. In fact, the **Recommended Article** is not a redundancy. The Law on Financial Institutions does not set forth the transaction of leasing with precision. Further, what ideas of leasing are conveyed, do not reflect current international standards. Finally, the definition of leasing in the current law ends with the words "to the extent permitted by law." This invites clarification by a regulatory body such as the BNA. The **Recommended Article** is designed to provide such clarification by referencing international standards.

Recommended Article #2: This Article will assert the primary and exclusive authority of the National Bank of Angola to regulate leasing as defined above, including the power to impose conditions in the conduct of the leasing business, irrespective of the identity of the lessee, when the lessor is a bank or a leasing company as defined under law.

Proposed Aviso Language (Article #2): *The National Bank of Angola has primary and exclusive authority to regulate leasing as defined above including the power to impose conditions in the conduct of the leasing business, irrespective of the identity of the lessee, when the lessor is a bank or a leasing company as defined under law.*

Explanation #2: Although Articles 4.2 and 6.2 of the Law on Financial Institutions appear to give the BNA the authority in theory to regulate leasing activity, discussions with BNA the week of July 7 reveal that such an interpretation of these parliamentary laws cannot be taken for granted. This is especially true since Article 4 of that law could be read to imply that banks may be free to undertake leasing, routinely and always free of restriction. A statement in an Aviso reasserting the authority of the BNA is thus desirable to clarify BNA authority over the conduct of the leasing business by both bank and non-bank institutions.

Meetings held the weeks of July 14 and 21 at the BNA suggested that regulation of Article 5 on non-bank financial institutions is in the manner of "prudential regulation." The **Recommended Article** asserting BNA authority in the area of non-bank institutions is fully consistent with a philosophy of prudential regulation because it will set forth the international standards for leasing and elaborate on legal aspects to protect leasing transactions.

Recommended Article #3: This Article will provide that banks may directly engage in the activity of leasing without resort to any specific business form, including but not limited to a leasing company. This Article will further provide that non-bank financial institutions may only engage in leasing through means of a leasing company.

Proposed Aviso Language (Article # 3): *Banks may directly engage in the activity of leasing without resort to any specific business form, including but not limited to a leasing company. Non-bank financial institutions may only engage in leasing through means of a leasing company.*

Explanation #3: This **Recommended Article** provides needed clarity on a central point left open by the Law on Financial Institutions. That law leaves open the extent to which the BNA may condition the operations of leasing or factoring under law. The BNA has this authority under Articles 4.2 and 6.2. Meetings and discussions with BNA regulators the weeks of July 7 and 21 resulted in the conclusion that the BNA could condition leasing by imposing the requirement of separate companies for the transactions of banks.

The issue is whether the BNA chooses to immediately exercise this authority. The present judgment of the BNA at various levels is not to immediately exercise its authority to condition leasing operations. The main reason for the "hands off" approach seems simple enough: let the transactions develop and then condition later if needed. Mention has also been made that the imposition of a company structure might impair banks from entering the market for leasing.

This being the case, the issue is then why a **Recommended Article** on this subject is needed at all. The answer is rather simple. On virtually every occasion in which the Mission was asked to speak on the subject, the BNA first contended that it did not have the legal authority to compel banks to use a company structure. Then, after discussion, the BNA agreed it had the authority but would not use it. If there is an issue within the BNA on this subject, there will likely be uncertainty in the business community. Therefore, the **Recommended Article** addresses the issue "head on."

The second reason for the **Recommended Article** is equally important. Not only does the **Recommended Article** resolve the issue for now, the **Recommended Article** demonstrates more fundamentally that format for leasing is an issue. This will send a signal to the financial community that the BNA is aware of the issue – and may in the future regulate it. Reasons are based on a variety of perspectives relating to the business community, supervisory resources within commercial banks and the BNA, and larger policy considerations. Among them are:

-Encouragement of capital flow – uniform requirements as between banks and non-banks will encourage leasing from a variety of bank and non-bank sources by creating a "level playing field" between funds from banks and funds from non-banks. Leasing companies, not banks engaged in leasing, accounted for the leasing boom in the United States in the 1960s-70s. (See The Conference Board, 21-23). The importance of a level playing field is not to be missed. In most countries, there are legal implications.

-Ease of administration - uniform requirements as between banks and non-banks will make supervision easier by permitting isolation of risk due to leasing, rather than having bank risk assessed from an agglomeration of transactions such as loans, leases, exchange risks and the like.

-Focus on SME development – unlike commercial banks, leasing companies typically concentrate on finding needed sources of funding for leasing from a variety of sources. (See The Conference Board, 20-21). The contribution of leasing companies in developing the SME sector is well documented. This contribution has also been cited by the BNA and USAID as part of the "success story" of leasing in Romania. (See USAID-BNA Operationalizing in Angola). The crowded agenda of commercial banks is unlikely to permit a dedicated focus on SME development. All the meetings the Mission had with commercial banks the weeks of July 7 and 14 point to this conclusion. On the other hand, bank formation of a leasing company will permit both a dedicated focus targeting SME submarkets and the tailoring of monitoring activities to achieve efficiencies in management.

-Ease in product evaluation by lessees– potential lessees will naturally wish to compare as between bank and non-bank lessors. By imposing the uniform requirement of a leasing company, potential lessees will find clarity in "comparative shopping" for the most appropriate service provider.

-Signal to supplier community – banks are among the most traditional and reliable of financial institutions. The community of suppliers of leased goods in financed transactions will be encouraged by their active participation in leasing. But the bank needs to demonstrate commitment to this line of business. Imposition of the leasing company requirement will convince the supplier community of bank seriousness.

-Needed focus on compliance – the outset of leasing and factoring in any country gives rise to questions and abuses. To minimize misunderstandings and abuses, international practices indicate that there are three key points of control in any organization: the legal function, the accounting function and the regulatory compliance function. Meetings the week of July 21 with BNA supervisory personnel suggest that, in evaluating commercial banks for fulfillment of "subjective" standards of fitness, evaluation of in house legal departments is not regarded as important. When leasing commences, legal department evaluation for fitness will have to be important along with the accounting and compliance functions. The BNA response illustrates a larger point: the myriad activities of banks make focus on any one transaction or any one aspect of a commercial bank management team less than feasible. In contrast, a requirement of leasing subsidiaries will facilitate a focus on the legal, accounting and compliance roles more easily.

Thus, a number and variety of reasons for active interest in and supervision of format for leasing activity is significant. It should be grounds for vigilant attention to the issue. Both USAID and BNA have invited further comment on the "what if" of a problem bank directly involved in leasing. The BNA may start by making managerial and operation competence in the area of leasing a primary area of assessment in supervision. It might then develop a list of criteria that support a given bank directly engaged in leasing to convert to special company status. Among the criteria would be:

-Impairment of bank capital as a result of increased or irregular leasing activity;

-Evidence of a failure of in-house bank control mechanisms (focus on law, accounting, and regulatory compliance);

-Evidence that the product has been a tool for favoritism and "insider dealing" in violation of corporate governance standards;

-Evidence of a direct or indirect threat to bank deposits;

-Abnormally high rates of abandonment or abuse of leased property;

-Any other criteria thought to bear on bank "safety and soundness".

The Mission encourages active contingency planning by the BNA in this regard.

Recommended Article #4: This Article will provide that any party providing value to advance leasing as defined herein, including but not limited to lessors or suppliers, will have a security interest as a matter of law in the property subject to the lease. This Article will expressly stipulate that the security interest will give the lessor, or supplier, recourse to the property in the event of default under the contract supporting the lease, or supply arrangement and will have the status of a guarantee. This Article will further provide that this security interest will exist as a matter of law, as set forth in this Article. This Article will further provide that the security interest conferred under this Article will confer on lessors and suppliers an interest that will be *pari passu* (that is of equal rank) to an interest that any other party has in the property as a matter of law.

Proposed Aviso Language (Article #4)*: Any party providing value to advance leasing as defined herein, including but not limited to lessors or suppliers, will have a security interest as a matter of law in the property subject to the lease. The security interest will give the lessor or supplier, recourse to the property in the event of default under the contract supporting the lease, or supply arrangement and will have the status of a guarantee. This security interest will exist as a matter of law, as set forth in this Article. The security interest conferred under this Article will confer on lessors and suppliers an interest that will be pari passu (that is of equal rank) to an interest any other party has in the property as a matter of law.*

Explanation #4: Article 1311 of the Civil Code provides that owners of property have the right to reclaim property by any legal means. Meetings and interviews on the subject of the capacities of the Commercial Register to satisfy an expansion of security interests have been "mixed." Some interviewees have emphasized the role of the Commercial Register in mandatory registration of certain forms of property such as land and automobiles. Other interviewees have indicated that, while there are some mandatory aspects of registration, the Commercial Register is also permissive. That is, firms register what they wish. At the very least, the picture, especially in the critical financial community, is that the Commercial Register either is incapable of handling, or does not in fact handle, significant aspects of commercial property, such as industrial equipment, in the case of leasing. The **Recommended Article** will encourage leasing by recognizing the security interests of lessors and suppliers as a matter of law. The **Recommended Article** places the security interest of such parties on the order of all other parties possessing a security interest in property as a matter of law.

Nor is it the case that the **Recommended Article** is making up new law. Rather, in this case, the BNA is merely following existing law and interpreting diverse Articles 686-720 of the Civil Code. These articles permit voluntary mortgages or "hipotecas." Yet the same articles recognize that mortgage obligations, and other security interests, may come from a variety of transactions. In effect, the **Recommended Article** interprets these articles to provide notice that voluntary leasing transactions will be regarded as creating security interests or "hipotecas" in lessors and suppliers.

The identification of the legal consequence of the security interest as a guarantee is important. While the Code of Civil Procedure appears to treat the issue of liquidation, there is infrequent reference to an order of priority among creditors based upon secured status. (See Code of Civil Procedure, Articles 1135-1362,

especially Articles 1148, 1249). Article 1148 is less than precise. Normally, greater and more definitive statements of priorities among creditors occur in laws on bankruptcy. However, meetings held the week of July 7 suggest that Angola does not have a formally articulated law on bankruptcy. Lack of development in this area of the law shows a serious deficiency in the legal regime, given international standards. The most desirable reforms are most likely, long term undertakings. The **Recommended Article** is designed to provide the minimum necessary to encourage the development of a viable leasing and factoring transaction by conferring on the lessor or the supplier a security interest equal to that of any party under law, regardless of when such interest was acquired.

Of course, the typical leasing transaction under international standards involves the retention of title with the lesssor. However, the international trend is that the issue of title is becoming less conclusive as to identifying a transaction, especially in the case of finance leasing. (See Article 8, UNIDROIT [absence of lessor warranty on issue of lessor title]). Additionally, interviews and meetings held the weeks of July 7 and 14 suggest that resolution of the issue of title does not rest exclusively on the Commercial Register, even as to property that is registered there under. Therefore, as in the **Recommended Article**, a clear statement under law, of the lessor's security interest in the property subject to lease, is in order. It will avoid title disputes and unnecessary use of courts.

Additionally, leasing and factoring can take several forms and the law must be flexible to accommodate the interests of all parties at any point during a transaction. The terms of a contract of lease might contemplate ultimate title in the lessee, through exercise of an option to purchase or otherwise. If, for example, the option entails change of title from the lessor, the lessor may be protected by the security interest until payment is made in full. Sale-leaseback transactions are still another example in which title may not always be in the lessor, and the lessor may nonetheless require protection. Finally, **Recommended Articles # 8-9** below interpret Angolan law so as to give lessors an interest in income from leased property as well as the interest in the leased property. This **Recommended Article** compliments that provision, since Angolan law can be read for the proposition that title to property is not the same as title to income derived from the property. Adoption of this **Recommended Article** and **Recommended Articles # 8-9** will be crucial to bringing lease products to lessees at the SME level. USAID and the BNA deem this as a critical role for the tool of leasing. (See USAID-BNA Operationalizing in Angola). Leasing at this level means lessors are accorded special protections.

Finally, a general word is in order relative to the role of the BNA and the Aviso. The Mission fully understands that it may be offering understandings of existing Angolan law that have not been articulated to this point. Given the unusual nature of leasing, this is not unusual in any country. The key is to use existing law to accommodate the realities of these transactions in a fast paced global environment. The objection may be made as to this **Recommended Article #4,** and as to **Recommended Articles #8-9** especially that the BNA is making "new law" in an Aviso. The Mission disagrees. Articles 4.2 and 6.2 of the Law on Financial Institutions" give the BNA not only the authority to explain the transactions, but to impose conditions on them so as to make leasing operable. This is especially true in the SME environment. Articles 16 and 21 of the Law On the National Bank are also highly relevant. The former gives the BNA the authority to advise all branches of government on matters of finance, a subject that surely covers leasing. The latter article gives the BNA authority to supervise banks and non-banks, including in the areas of leasing. The interpretation of existing Angolan law to make the transactions more acceptable is an aspect of BNA responsibility.

Recommended Article #5: This Article will stipulate that the security interest in property subject to transfer in a lease transaction will be subject to a security interest noted above under the following conditions: (i) as to property subject to the Commercial Register, at the time of official recordation in the Commercial Register; and (ii) as to property not subject to recordation in the Commercial Register, upon the earlier of : (a) transfer of possession and use of the property subject to lease to the lessee; (b) execution of the contract of lease or supply by the lessee; or (c) possession of negotiable instruments by

the factor as to letters of credit, bills of lading, cheques and other negotiable instruments under the Commercial Code.

Proposed Aviso Language (Article #5)*: The security interest in property subject to transfer in a lease transaction will be subject to a security interest noted above under the following conditions: (i) as to property subject to the Commercial Register, at the time of official recordation in the Commercial Register; and (ii) as to property not subject to recordation in the Commercial Register, upon the earlier of: (a) transfer of possession and use of the property subject to lease to the lessee; (b) execution of the contract of lease or supply by the lessee; or (c) possession of negotiable instruments by the factor as to letters of credit, bills of lading, cheques and other negotiable instruments under the Commercial Code.*

Explanation#5: International standards dictate that, if a system establishing security interests is created, the law needs to stipulate precisely when such an interest begins. This **Recommended Article** does so. As noted above, the scope of the Commercial Register is quite limited in terms of scope as to commercial property. And, even as to the property covered in the Commercial Register, interviews the week of July 21 confirm that time of registration as an internal administrative matter may vary, depending on the property registered. The **Recommended Article** is designed to provide clarity on the key issue of when the security interest arises. Article 122 of the Commercial Code very strongly implies that security interests fall within its ambit, at least as to the types of property covered by the Commercial Register. Meetings the week of July 21 with Commercial Register officials and others confirm this.

The **Recommended Article** is intended to provide clarity here. Strictly speaking, banking regulation is not the logical place to set forth the rights of secured parties. However, three points should be made. First, the BNA is largely interpreting very general legal principles and making them applicable to leasing. Unlike the civil codes of many countries, the current Civil Code in Angola appears to contain little specific references to a law on pledges generally. The closest approximation appears to be a series of articles on mortgages. (See Articles 686-735, Civil Code). In addition, various articles of the Civil Code seem to speak of priority among creditors. (See Civil Code Article 733 et seq). However, dialogue with BNA attorneys the week of July 21 confirm that while the article speaks of priority, they do not principally address the issue of when a party becomes a secured creditor. The **Recommended Article** does. The point is not that such points are not existent; rather it is that the code is not currently designed to take the particulars of modern leasing into account. Hence, elaboration by the BNA as regulator seems appropriate.

Secondly, although international standards very much support the trend to detailed development as respects the rights of secured parties (including clear statements of when the right arises and priorities as among secured parties), it is very difficult to discern a clear trend as to how given jurisdictions arrive at a detailed articulation on security interests. This is because the issue of the rights of secured parties is very much tied up with the issue of land transfer and mortgage, which is highly influenced by local traditions and preferences. Meetings the weeks of July 7 and 14 confirm this tendency in Angola. Therefore, BNA intervention as to the question of security interests in the context of leasing is appropriate. Thirdly, Articles 4.2 and 6.2 of the Law on Financial Institutions mandate that the BNA develop definitions for the purpose of giving effect to leasing and factoring by banks and for regulating leasing and financing by non-bank financial institutions generally. Thus, the BNA has very broad authority to clarify key aspects of leasing. Surely this includes providing definitive guidance on the rights of secured parties, without which leasing and factoring will not occur.

As respects types of property covered in the **Recommended Article**, the intention is to cover various laws within the Commercial Code dealing with bills of lading, cheques and other negotiable property.

Recommended Article #6: This Article will provide that, notwithstanding the terms of an individual contract of lease or other document, the National Bank of Angola will take into account one or more of the following factors to support a National Bank of Angola determination that a transaction is a finance lease:

-The lessee assumes title and ownership in the property subject to the contract of lease at some point in the commercial relation with the lessor;

- The lease duration is coextensive or approximately coextensive with the economic life of the property subject to the contract of lease;

-The lessee engages in the selection of the property subject to the lease, for purposes of acquisition from a supplier by either the lessee or the lessor;

-The contract of lease provides for the option of the lessee to purchase the property subject to lease, at the conclusion of the lease term;

-The contract of lease provides for the ability of the lessee to renew or extend the lease at the conclusion of the lease term;

-Amortization of the leased property is based on the entire cost of the property subject to lease;

-The totality of the commercial circumstances otherwise indicates that the lessor has less than significant connection to the property subject to the lease contract, as indicated by its lack of expertise to manage said property, or lack of geographic proximity, lack of economic investment in the property or a variety of other factors deemed significant by the National Bank of Angola.

The Article will conclude by providing that, in the event that the above factors do not support a finding that a transaction is a finance lease but that it is nonetheless a lease as defined above, the National Bank of Angola will determine that the lease is an operating lease.

Proposed Aviso Language (Article #6)*: Notwithstanding the terms of an individual contract of lease or other document, the National Bank of Angola will take into account one or more of the following factors to support a National Bank of Angola determination that a transaction is a finance lease:*

-The lessee assumes title and ownership in the property subject to the contract of lease at some point in the commercial relationship with the lessor;

- The lease duration is coextensive or approximately coextensive with the economic life of the property subject to the contract of lease;

-The lessee engages in the selection of the property subject to the lease, for purposes of acquisition from a supplier by either the lessee or the lessor;

-The contract of lease provides for the option of the lessee to purchase the property subject to lease at the conclusion of the lease term;

-The contract of lease provides for the ability of the lessee to renew or extend the lease at the conclusion of the lease term;

-Amortization of the leased property is based on the entire cost of the property subject to lease;

-The totality of the commercial circumstances otherwise indicates that the lessor has less than significant connection to the property subject to the lease contract, as indicated by its lack of expertise to manage said property, or lack of geographic proximity, lack of economic investment in the property or a variety of other factors deemed significant by the National Bank of Angola.

In the event that the above factors do not support a finding that a transaction is a finance lease but that it is nonetheless a lease as defined above, the National Bank of Angola will determine that the lease is an operating lease.

Explanation #6: As leasing advances in jurisdictions, the distinction between finance and operating leasing becomes important. International experience indicates that the distinction is vitally important in tax laws. Typically, in cases of ambiguity, lessees prefer to consider leases as operating leases because

finance leases usually feature significant additional charges (depreciation, interest payments, maintenance, etc.) in the early years of the lease. Lessors in many countries prefer designating a transaction a finance lease, in which case initial interest charges will be high. International experience suggests that formulation of tax legislation is bound to make the distinction between operating and finance leases relevant – and, for this reason, lead to the structuring of lease transactions that are ambiguous.

This **Recommended Article** is intended to provide early guidance to the financial and tax regulatory communities in Angola. This **Recommended Article** balances two factors. One is the need for the financial community serving Angola to have a profile of factors that differentiate finance from operating leasing. The second factor is the absence of experience with leasing in Angola. As a result, the **Recommended Article** sets forth a variety of factors supporting the determination of a finance lease, without naming any one. This helps both the National Bank of Angola and the financial community. The Bank of Angola has discretion to examine given transactions under a variety of criteria. The financial community has the ability to structure a transaction so as to reasonably support a determination of finance or operating lease depending on the intent of the parties. For example, the principles of the Financial Accounting Standards Board (FASB), a professional accounting association based in the United States and having worldwide impact, has deemed passage of title as determinative in terming a lease a finance lease. This factor is certainly prominent in the **Recommended Article**. (See FASB Statement No. 13, circa 1978). However, the **Recommended Article** takes in the significance of passage of title to the lessee, but makes this only one of several factors. This is to accept the reality that the state of ownership or "title" in Angola is less then firmly settled at present, according to different sources in the private sector and the donor community contacted in meetings during the weeks of July 7 and 14.

The above factors reflect the current state of international standards. The **Recommended Article** reflects the emphasis in the United States and the UNIDROIT Model Law that lessee control of the acquisition of the leased property is a key factor. However, the **Recommended Article** also reflects the UNIDROIT emphasis on the importance of amortization based on the total cost of the property subject to lease, and a major determinant that a transaction is a finance lease and not an operating lease. (Compare Article 2A, Uniform Commercial Code [definition of finance lease] with Article 2 UNIDROIT Model Law).

Finally, the assumption that if a lease is not a finance lease, it is deemed an operating lease is fairly common in international practice. (See Cf. [FASB Statement No. 13, circa 1978]).

Recommended Article #7: This Article will provide that, unless agreed to by the lessor, the lessee, and any assignee or delegated party of contract of lease rights or duties, the lessee may not assign rights under the contract of lease or delegate duties under same to a party not a party to the original lease transaction.

Proposed Aviso Language (Article #7)*: Unless agreed to by the lessor, the lessee, and any assignee or delegated party of contract of lease rights or duties, the lessee may not assign rights under the contract of lease or delegate duties under same to a party not a party to the original lease transaction.*

Explanation #7: Meetings the weeks of July 7, 14 and 21 suggest that the typical lease transaction in Angola is likely to involve lessor retention of title, while the lessee selects the property subject to the lease for acquisition from a supplier. In this context, there is a complication with lessee assignments without the consent of the lessor. According the lessee unlimited and unrestricted power of assignment and delegation would create a situation in which the leased property is outside the control of the lessor, while the transaction now depends upon an assignee or delegated party whose creditworthiness and general ability to perform have not been established. Even jurisdictions that encourage leasing will discourage this practice. (See A Summary, Uniform Commercial Code Article 2A Amendments [1990]). The **Recommended Article** reflects a prudent restriction in order to encourage leasing.

Recommended Article #8: This Article will provide that the scope of the security interest in property subject to lease will include proceeds and income generated from such property. The Article will further

provide that, in the absence of clear evidence to the contrary, all income and economic value in a lessee will be deemed to have been generated by the property subject to lease.

Proposed Aviso Language (Article #8)*: The scope of the security interest in property subject to lease will include proceeds an income generated from such property. In the absence of clear evidence to the contrary, all income and economic value in a lessee will be deemed to have been generated by the property subject to lease.*

Explanation #8: "Income" is that which the property earns from active operation; "proceeds" is that which is received when the property subject to lease is sold or transferred. Meetings the weeks of July 7 and 14 stressed that would be lessor's lack of effective judicial enforcement would be a primary impediment to leasing in Angola. Of course, banks and other lessors are likely to impose stringent requirements on lessees in case the property subject to lease disappears or is severely damaged. And in the long run, judicial reform to reflect commercial realities is no doubt needed. However, these factors are outside the immediate control of the BNA to improve enforcement measures in the context of leasing. The **Recommended Article**, on the other hand, will encourage leasing by providing lessors with some protection when judicial relief appears to be a remote prospect. The **Recommended Article** will give the lessor recourse to business income generated from the property.

One might justify the **Recommended Article** on both business and legal grounds. First, because leasing is full financing in the sense that the lessee very often makes no down payment, a lessor bank or non-bank needs to make a determination of the economic usefulness of the property in the hands of the lessee, and the ability of the property to generate income to support regular payments made by the lessee. Thus, legal authority clearly stating a right to income generated from property is entirely appropriate. Secondly, meetings with attorneys from the BNA the week of July 21 suggest that the relation of income from property to the property itself already exists in the law of Angola. (See e.g., Article 656 of the Civil Code). However, these provisions do not make the tie automatic. The **Recommended Article** does. Further, current law in Angola relies on the concept of property subject to registration. This category is far less than fully inclusive of all commercial property. The **Recommended Article** is comprehensive as to type of property.

The **Recommended Article** is fully consistent with the modern commercial standard in which a security interest in an asset includes the proceeds derived from it. (See e.g., Article 9-203, 9-306, Uniform Commercial Code, New York Consolidated Laws Service). Income derived from property subject to lease might be likened to proceeds from leased property. This is because, in leasing, the income generated from property subject to lease is used to make leased payments. In turn, the lessee often takes title to the property after exercising an option to purchase. In this context, income is, in effect, tantamount to proceeds, or economic value on exchange.

Recommended Article #9: This Article will provide that, if lessee violates the terms of the contract of lease, the lessor may take all steps under law to assume possession and control of other items of economic value owned by lessee, provided that these items are subject to claim by the lessor under law or contract other than through the contract of lease, in addition to and other than the property subject to lease. This Article will further provide that the lessor will have rights in these items identical to lessor's right in the property subject to lease.

Proposed Aviso Language (Article #9)*: If lessee violates the terms of the contract of lease, the lessor may take all steps under law to assume possession and control of other items of economic value owned by lessee, provided that these items are subject to claim by the lessor under law or contract other than through the contract of lease, in addition to and other than the property subject to lease. The lessor will have rights in these items identical to lessor's right in the property subject to lease.*

Explanation #9: This **Recommended Article** elaborates on the principle of a lessor right to repossession of property as articulated under Article 1311 of the Civil Code. This **Recommended Article** expands the

lessor's rights to property beyond property subject to lease, in the event that the lessee violates the contract of lease. This **Recommended Article** gives the lessor right to proceed to seize all property to which lessor has a claim against the lessee because of contract or law, outside the contract of lease. In effect, the **Recommended Article** says that if there is a breach of the contract of lease, the lessor may treat all of lessee's property as if it were the property subject to lease, provided that the lessor has some claim to such property under law or contract (other than the contract of lease).

Interviews the weeks of July 7, 14, and 21 indicate that banks and potential lessors do not view self-help and repossession of property to be a large problem under current circumstances. However, two points need to be made. First, in the event of finance leasing in Angola, the lessor may finance 100% of the value of the property. This could encourage misuse and misappropriation of the property subject to lease by the lessee. Therefore, to encourage leasing by banks and other financiers, lessors need more recourse to lessee property. "Cash poor" lessees in the SME echelon of the economy may not have the liquid assets to meet a cash collateral requirement. Lessors need the assurance that they may go against many forms of lessee property in the event of a default under the contract of lease by the lessee. The **Recommended Article** achieves this. Secondly, the peculiarities of leasing transactions give rise to issues of repossession, which in turn give rise to issues of who has legal title under a lease. Angola's less than comprehensive Commercial Registry, one that arguably does not cover all commercially significant property, aggravates the problem. Rather than argue over title in court, the **Recommended Article** gives the lessor power to proceed against lessee property (outside the lease) in which lessor has an interest, if the lessee breaches the contract of lease. This facilitates lessor recovery of property without the formalities of court. Here, it might be noted that leasing jurisdictions such as the United States and India have faced lawsuits by lessees alleging lessor misconduct in repossession. This **Recommended Article** should, if adopted, largely deter lessee misbehavior as respects the property subject to lease. The **Recommended Article** will avoid needless litigation and delay in enforcement of lessor rights.

Finally, it might be observed that the **Recommended Article** incorporates "cross collateralization," a contract protection for lender banks, into public law of an "Aviso." However, this use of private contract principles in public law should not give rise to objection. Evolving international standards in the area of leasing frequently incorporate ideas from the private sector, as even recent trends attest to the vitality of public law on the subject of leasing. (See Castillo-Triana, 10).

III. RECOMMENDED REGULATION FOR FACTORING TRANSACTIONS BY THE NATIONAL BANK OF ANGOLA

Preface: The Bank of Angola (BNA) has requested assistance of the Financial Sector Program in Angola, an initiative sponsored by the United States Agency for International Development (USAID). This assistance is targeted to the development of an "Aviso" or high level decree from the BNA concerning the key legal aspects of factoring, and related concerns to facilitate an enabling environment to encourage factoring.

The background for the request is in the context of the current legal and business climate for factoring in Angola.

Today neither the Civil Code of Angola, nor its Commercial Code, nor related parliamentary legislation, elaborate on the commercial aspects of factoring transactions, or address attending legal responsibilities given international standards. There is no commercial law devoted exclusively or mainly to the subject of factoring.

Instead, what elaboration Angola's parliamentary laws provide is less in the context of commercial law and more in the nature of the law on financial regulation. Specifically, Articles 4.1 g and Article 5.1 d of the "Law on Financial Institutions" grant authority to bank and non-bank financial institutions, respectively, to engage in factoring. However, discussions held the weeks of July 7, 14, and 21, 2008 confirm that, unless elaborating regulation is provided:

(a) Efforts to conduct factoring would, at best, only approximate factoring as conducted pursuant to best international practices;

(b) Execution of factoring transactions would be of uneven quality, with some financiers borrowing from international experiences, and others having little guidance as to how to conduct factoring transactions; and

(c) Supporting and enabling public institutions necessary to enhance factoring will not receive proper scrutiny for readiness, as only regulations can signal a proper commitment from the BNA and the national government to ensure that such institutions as courts, accountants and law enforcement officials are prepared for such transactions

The following **Recommended Articles** are designed to become key elements of such a needed Aviso. Meetings held the weeks of July 7, 14, and 21 confirm that such an Aviso should contain a clear statement of general principles and be flexible enough to last through the initial introduction of factoring products, through an intermediate implementation period of three to five years. Hence flexibility is needed. Meetings within the BNA during this period confirm that the hierarchy of legal authority issued by the BNA encourages a flexible approach; the subordinate legal authority inherent in "directivas" and "instructivos", elaborate on Avisos and provide additional, more detailed requirements. After experience gained over three to five years with these series of subsequent "Directivas" and "Instructivos," – issued as the market evolves and such direction and guidance becomes necessary – some of the more important concepts might be included in a future, more comprehensive Aviso. These subordinate forms of legal authority governing factoring practices might also be used to develop and to promulgate elaborations that might be tested in the actual practice of factoring in Angola.

The factoring specialists of the USAID Financial Sector Program in Angola realize and encourage constant reconsideration of the BNA leasing and factoring initiative to ensure conformity to local realities. For this reason, the material presented below has two notable characteristics. First, to demonstrate connection of international standards and business practices, each **Recommended Article** below contains an ***Explanation***, referring to either these standards or to local considerations, notably those in Angolan law. Secondly, to promote maximum understanding in the BNA, the **Recommended**

Articles are not written in formal legal language. The factoring specialists (here-in-after identified as the "Mission") have drafted the **Recommended Articles** so that they will be easily rendered into correct formal legal style in Portuguese.

And this leads to a third component of the presentation. It is an attempt at rendering each **Recommended Article** into the approximate language of an Aviso. This has been undertaken at the request of the BNA. This rendering of approximate Aviso language appears between each **Recommended Article** and the ***Explanation***, under the title **Proposed Aviso Language**. A caution: there are very significant limitations to attempts at rendering exact wording from one language into another; this is doubly true in the area of the law where expressions are highly specialized and idiomatic. Among the limitations in the **Proposed Aviso Language** are that "exact language" drafts of legal documents can only be fully successful if:

> -There is considerable expertise in the legal vocabularies of two legal cultures, in this case Anglo-Saxon and Angolan Portuguese, coupled with deep experience in the transposition of the two languages in a wide variety of contexts;
>
> -There is intimate understanding of BNA manners of phraseology, executive legal style and related matters (covering such issues as determining the order, numbering and length of articles, manner of stating conditions and qualifications, cross-referencing legal authority outside the BNA and the like); and
>
> -There is great understanding of the interplay of the BNA technical department involved, the Supervision Department, and the Legal Department, and, indeed, the interplay between BNA and other branches of the executive structure of Angola

Limited resources and time, did not permit the Mission to acquire any of the above capabilities necessary to make a "word for word" rendering completely successful. This means that the BNA will have to give special attention in considering the **Proposed Aviso Language** accompanying each **Recommended Article**. First, careful consultation of the **Recommended Article** and its *Explanation* is needed to ensure that the fullest meaning is captured by the **Proposed Aviso Language**. Secondly, BNA personnel are strongly encouraged to borrow on the breadth of experience represented by the Legal Department of the BNA, especially as to issues of legal vocabulary and international legal standards. Thirdly, effecting factoring means understanding economics, finance, accounting, tax policy, and formal regulatory process outside the BNA. Prior to committing to the language of any single draft, including the **Proposed Aviso Language**, it is recommended that the BNA avail itself of offices of the Angolan government and the private sector generally, as to issues of vocabulary, international standards, and others connected with the subject matter.

Finally, the Mission recognizes limits imposed on the exercise below, either because of the nature of the Mission or because of limitations imposed on the BNA. As to the latter, no central bank can be completely responsible for an effective enabling environment for factoring. This requires an efficient and fully responsive commercial court system, transparent procedures for registration of ownership and security interests in all commercial property, operating credit reporting agencies, and accounting and legal professions that widely understand these transactions. It is hoped that the **Recommended Articles** below become a basis for a BNA Aviso that will spur entities in Angola, both in and out of government, to promote factoring. The **Recommended Articles** were phrased very much with existing limitations in mind. Secondly, the treatment below does not deal with immovable property subject to factoring. This is because of an understanding, reached between USAID and the BNA prior to the Mission, that the complicated and highly specialized field of real estate would be left outside the tasks of the three week Mission.

Because the **Recommended Articles,** the **Proposed Aviso Language** and *Explanations* were formulated after careful consideration, it is highly advisable that they remain together at all stages of the evaluation process, both inside and outside the BNA. Because factoring is an exceptional commercial transaction

everywhere, it is highly unlikely that any **Recommended Article,** and its companion **Proposed Aviso Language,** will be appreciated without its *Explanation*. Also, the **Recommended Articles** and *Explanations* should be a familiar format to any lawyer from a civil code country. The *Explanations* are, in effect, like expert jurist commentary on any given proposed article of a code. The Mission understands that the BNA may have a format of analysis that departs from this more legal presentation. Since the Aviso is a legal product, it is highly advisable that any draft from the **Recommended Articles** and the **Proposed Aviso Language** first appear in draft form as a legal product. Thereafter, non-legal constituents within or outside the BNA may reduce it to any template they choose to facilitate their evaluation.

Recommended Article #1: This Aviso provides the definition of factoring.

Proposed Aviso Language (Article #1): *This Aviso No…..regulates factoring (Cessao Financeira), a commercial transaction approved by the Law on Financial Institutions (Law No. 13/05 of the 30th of September) and subject to the jurisdiction of National Bank of Angola (BNA).*

Explanation #1: This **Recommended Article** is consistent with international business standards. In addition, the definition is generally consistent with the broad outline of factoring set forth in Article 2 of the Law on Financial Institutions.

Recommended Article #2: **This Recommended Article** will assert the primary and exclusive authority of the National Bank of Angola to regulate factoring as defined above, irrespective of the identity of the client and the debtor, when the factor is a bank or a factoring company as defined under law.

Proposed Aviso Language (Article #2): Definitions - Factoring (cessao financeira) *is a short-term commercial transaction whereby a business sells its accounts receivables* ***(faturas)*** *at a discount. In accordance with the Law on Financial Institutions , factoring can be done by banking entities (Article 4, 1g) and also by non-bank financial institutions such as factoring companies ("sociedades de cessao financeira") (Article 5 , 1 c).*

1. Factoring is the short-term acquisition of an account receivable generated through the sale of a product or a service, domestic or foreign. Factoring is not a loan and it involves at least three parties: the invoice seller (aderente), the debtor (devedor), and the factor (cessionario ou factor). To be considered a factoring transaction, the maturity date from the time of purchase of the invoice by the factor should not exceed 180 days.

2. Factor ("Cessionario ou Factor"): an entity which acquires at a discount the account receivable or invoice which represents value for the sale of a product or a service.

3. Seller ("Aderente"): the party which sells its accounts receivable to the factor, normally at a discount to its face value. This discount represents remuneration to the factor for services related to the purchase of the invoice and/or compensation for the cost of funds advanced under the factoring transaction.

4. Debtor ("Devedor"): the party which owes payment to the seller. In a factoring transaction, the debtor pays the full value of the invoice to the factor.

5. Factoring Companies ("Sociedades de Cessao Financeira"): are non-bank financial institutions whose exclusive objective is the exercise of factoring activities.

6. Recourse Factoring: Factoring in which the factor does not take the risk of bad debt. In recourse factoring the factor has recourse to the Seller and is able to reclaim from the Seller's unpaid funds resulting from non-payment by the Debtor.

7. Non-recourse Factoring: Factoring in which the factor accepts the bad debt risk. The factor assumes all rights, including legal rights, to pursue the customer for payment and the Seller is exempt from reimbursement of any losses due to non-payment by the Debtor.

Explanation #2: This **Recommended Article** is intended to use the factoring terminology of the Law "On financial Institutions," in order to avoid confusion.

During meetings the weeks of July 7 and 14, members of the BNA raised the quite legitimate issue that Article 2 of the Law on Financial Institutions already defines factoring activities in the context of defining factoring companies. Thus, there was some issue as to whether a **Recommended Article** was a redundancy. In fact, the **Recommended Article** is not a redundancy. The Law on Financial Institutions does not set forth with precision either the transaction or factoring. Further, what ideas of factoring that are conveyed do not reflect current international standards. Finally, the definition of factoring in the current law ends with the words "to the extent permitted by law." This invites clarification by a regulatory body such as the BNA. The **Recommended Article** is designed to provide such clarification by referencing international standards.

A second point to keep in mind when drafting the final wording of the articles to be included in the recommended Aviso is that the BNA working group agreed that factoring should be viewed primarily as a "commercial activity." As such, precise definitions and detailed regulations should be avoided, to the extent consistent with the law, to encourage development and growth during this embryonic stage. Perhaps Mexico's experience is relevant to this point (discussed in Explanation #10).

Recommended Article #3: It is recommended that this Article assert the primary and exclusive authority of the National Bank of Angola to regulate factoring as defined above, irrespective of the identity of the client and the debtor, when the factor is a bank or a factoring company as defined under law.

Proposed Aviso Language (Article #3): Regulatory and Supervisory Jurisdiction *-In accordance with Articles 4.2 of the Law on Financial Institutions, it is the responsibility of the National Bank of Angola (BNA) to define the terms and conditions under which banking institutions may engage in factoring. Similarly, in accordance with Article 6.2 of the Law on Financial Institutions, the National Bank of Angola is responsible for the regulating and supervision of factoring companies.*

Explanation #3*:* This **Recommended Article** is intended to use the factoring terminology of the Law on Financial Institutions, in order to avoid confusion.

Although Articles 4.2 and 6.2 of the Law on Financial Institutions appear to give the BNA the authority, in theory, to regulate factoring activity, discussions with BNA the week of July 7 revealed that such an interpretation of these parliamentary laws cannot be taken for granted. This is especially true since Article 4 of that law could be read to imply that banks may be free to undertake factoring automatically, and, therefore, operate free of restrictions. A statement in an Aviso reasserting the authority of the BNA is thus desirable to clarify BNA's authority over the conduct of factoring by both bank and non-bank institutions.

Discussions held during meetings the weeks of July 14 and 21 at the BNA suggested that regulation under Article 5 for non-bank financial institutions is in the manner of "prudential regulation." The Recommended Article asserting BNA authority in the area of non-bank institutions is fully consistent with a philosophy of prudential regulation because it will set forth the international standards for factoring and elaborate on legal aspects to protect factoring transactions.

Recommended Article #4: This **Recommended Article** #4 will provide that banks may directly engage in the activity of factoring without resort to any specific business form, including but not limited to a factoring company. This Article will further provide that non-bank financial institutions may only engage in factoring through means of a factoring company.

Proposed Aviso Language (Article #4): AUTHORITY OF BANKING AND NON-BANKING FINANCIAL INSTITUTIONS TO ENGAGE IN FACTORING

1. *As non-banking financial institutions ("Instituições Financeiras Não Bancarias") factoring companies (Sociedades de Cessao Financeira) shall apply for their authorization and shall be authorized*

in accordance with Chapter VIII of the Law on Financial Institutions No. 13/05 of 30 of September and other Laws, as applicable. Factoring companies must establish themselves as commercial enterprises in the form of "Sociedade Anonima". They shall engage exclusively in factoring activities and activities directly related to the business of factoring.

2. Banking institutions engaged in factoring as financial institutions (instituições financeiras bancarias) shall be authorized, regulated and supervised by the National Bank of Angola in accordance with Chapter I of the Law on Financial Institutions No. 13/05 of 30 of September and other laws, as applicable.

3. The designation "Sociedade de Cessao Financeira" ou "Sociedade de Factoring" or others which may suggest that a company is primarily engaged in the business of factoring is exclusively for use by the type of banking and non-banking institutions defined above.

Explanation #4: This Recommended Article provides needed clarity on a central point left open by the Law on Financial Institutions. That law leaves open the extent to which the BNA may condition the operations of factoring under law. The BNA has this authority under Articles 4.2 and 6.2. Meetings and discussions with BNA regulators the weeks of July 7 and 21 have resulted in the conclusion that the BNA could condition factoring by imposing the requirement of separate companies for factoring transactions by banks.

The issue is whether the BNA chooses to immediately exercise this authority. The present judgment at various levels of the BNA is not to immediately exercise its authority to condition factoring operations. The main reason for the "hands off" approach seems simple enough: let the transactions develop and then provide conditions later, if needed. Mention has also been made that the imposition of a company structure might impair banks from entering the market for factoring.

This being the case, the issue is then why a **Recommended Article** on this subject is needed at all. The answer is rather simple. On virtually every occasion in which the Mission was asked to speak to the subject, the BNA first contended that it did not have the legal authority to compel banks to use a company structure. Then, after discussion, the BNA agreed it had the authority but would not use it. If there is an issue on this subject within the BNA, there will, most likely, be uncertainty in the business community. Therefore, the **Recommended Article** addresses the issue "head on."

The second reason for the **Recommended Article** is equally important. Not only does the **Recommended Article** resolve the issue for now. The **Recommended Article** demonstrates more fundamentally that a format for factoring is an issue. This will send a signal to the financial community that the BNA is aware of the issue – and may in the future regulate it. Rationale for this Recommended Article is based on a variety of perspectives relating to the business community, supervisory resources within commercial banks and the BNA, as well as larger policy considerations. Among them are:

(a) Encouragement of capital flow. Uniform requirements of banks and non-banks will encourage factoring from a variety of bank and non-bank sources by creating a "level playing field" between funds from banks and non-banks. The importance of a level playing field is not to be missed. In most countries, there are legal implications. One of the reasons for undertaking factoring is to secure related client business. Yet, most antitrust laws prohibit "product tie-ins" as anticompetitive. If Angola does not yet have an antitrust law, it soon will. Banks are not usually subject to antitrust regulation, but other companies are. If non-bank factoring companies perceive a bank advantage by virtue of exemption from regulation, they may avoid Angola. The better and simpler solution is a level playing field.

(b) Ease of administration. Uniform requirements for banks and non-banks will make supervision easier by permitting isolation of risks due to factoring, rather than having bank risk assessed from an agglomeration of transactions such as loans, leases, exchange risks, and the like.

(c) Ease of product evaluation and comparison by clients. Potential clients will naturally wish to compare banks with non-bank factors. By imposing the uniform requirement of a factoring company, potential clients will find clarity when "comparative shopping" for the most appropriate service provider.

(d) Positive message to the supplier community. Banks are among the most traditional and reliable of financial institutions. The community of clients and debtors will be encouraged by the banks' active participation in factoring. But the banks need to demonstrate commitment to this line of business. Imposition of the factoring company requirement will convince the business community of bank seriousness.

(e) Needed focus on compliance. The outset of factoring in any country gives rise to questions and abuses. To minimize misunderstandings and abuses, international practices indicate that there are three key points of control in any organization: the legal function, the accounting function and the regulatory compliance function. Meetings during the week of July 21 with BNA supervisory personnel suggest that, in evaluating commercial banks for fulfillment of "subjective" standards of fitness, the evaluation of in-house legal departments is not regarded as important. When factoring commences, legal functions will have to be evaluated, along with the accounting and compliance functions. The BNA response illustrates a larger point: the myriad activities of banks make focus on any one transaction or any one aspect of a commercial bank management team less than feasible. In contrast, a requirement of factoring subsidiaries will more easily facilitate a focus on the legal, accounting, and compliance roles.

Thus, the number and variety of reasons for active interest in and supervision of format for factoring activity is significant. It should be grounds for vigilant attention to the issue. Both USAID and BNA have invited further comment on the "what if" of a problem bank directly involved in factoring. The BNA may start by making managerial and operation competence in the area of factoring a primary area of assessment in supervision. It might then develop a list of criteria that support a given bank directly engaged in factoring to convert to a special company status. Among the criteria would be:

(a) Impairment of bank capital as a result of increased or irregular factoring activity.

(b) Evidence of a failure of in house bank control mechanisms to work (focus on law, accounting, and regulatory compliance).

(c) Evidence that the product has been a tool for favoritism and "insider dealing" in violation of corporate governance standards.

(d) Evidence of a direct or indirect threat to bank deposits.

(e) Any other criteria that might be considered as relevant to a bank's "safety and soundness."

The Mission encourages active contingency planning by the BNA in this regard.

- **Recommended Article #5**: This Article will provide that any party providing value to factoring as defined herein, including but not limited to factors, will have a security interest as a matter of law in the property transferred to the factor. This Article will expressly stipulate that the security interest will give the factor recourse to the property in the event of default under the factoring arrangement and will have the status of a guarantee. This Article will further provide that this security interest will exist as a matter of law, as set forth in this Article. This Article will further provide that the security interest conferred on factors under this Article will be *pari passu* (that is of equal rank) to an interest that any other party has in the property, as a matter of law.

Proposed Aviso Language (Article #5)*: *SECURITY INTEREST *Any party providing value to factoring as defined herein, including but not limited to factors, will have a security interest, as a matter of law, in the property transferred to the factor. Such security interest gives the factor recourse to the property in*

the event of default under the factoring arrangement and will have the status of a guarantee. This security interest exists as a matter of law, as set forth in this Article. Furthermore, this Article provides that the security interest conferred hereunder will confer on factors as a matter of law an interest that will be pari passu to an interest any other party has in the property.

Explanation #5: Article 1311 of the Civil Code provides that owners of property have the right to reclaim property by any legal means. Meetings and interviews on the subject of the capacities of the Commercial Register to satisfy an expansion of security interests have been "mixed." Some interviewees have emphasized the role of the Commercial Register in mandatory registration of certain forms of property such as land and automobiles. Other interviewees have indicated that, while there are some mandatory aspects of registration, the Commercial Register is also permissive. That is, firms register what they wish. At the very least, the picture, especially in the critical financial community, is that the Commercial Register either is incapable of handling, or does not in fact handle significant aspects of commercial property, such as accounts receivable and commercial paper, in the instance of factoring. The **Recommended Article** will encourage factoring by recognizing the security interests of factors as a matter of law. The **Recommended Article** places the security interest of such parties on the order of all other parties possessing a security interest in property, as a matter of law.

Nor is it the case that the **Recommended Article** is making up new law. Rather, in this case, the BNA is merely following existing law and interpreting diverse regulations in Articles 686-720 of the Civil Code. These articles permit voluntary mortgages or "hipotecas." Yet the same articles recognize that mortgage obligations, and other security interests, may come from a variety of transactions. In effect, the **Recommended Article** interprets these articles to provide notice that voluntary factoring transactions will be regarded as creating security interests, or "hipotecas", in factors.

The identification of the legal consequence of the security interest as a guarantee is important. While the Code of Civil Procedure appears to treat the issue of liquidation, there is infrequent reference to an order of priority among creditors based upon secured status. (See Code of Civil Procedure, Articles 1135-1362, especially Articles 1148, 1249). Article 1148 is less than precise. Normally, greater and more definitive statements of priorities among creditors occur in laws on bankruptcy. However, meetings held the week of July 7 suggest that Angola does not have a formally articulated law on bankruptcy. Lack of development in this area of the law shows a serious deficiency in the legal regime, given international standards. The most desirable reforms are most likely, long term undertakings. The **Recommended Article** is designed to provide the minimum regulation necessary to encourage the development of a viable factoring transaction by conferring, by law, a security interest on the factor equal to that of any other party under the law, regardless of when such interest was acquired.

Of course, the typical transaction under international standards involves the retention of title with the factor. Interviews and meetings the weeks of July 7 and 14 suggest that resolution of the issue of title does not rest exclusively on the Commercial Register, even as to property that is registered there under. Therefore, a clear statement under law, as addressed in the **Recommended Article**, of the factor's security interest in the property subject to the factoring agreement is in order. It will avoid title disputes and unnecessary use of courts.

The idea of a special security interest for factors has existed in commercially significant jurisdictions. (See Article 45, Personal Property Law, New York Consolidated Law Service [circa 1964]; and Commentary, Article 9-204, Uniform commercial Code, New York Consolidated Law Service, 1978). The **Recommended Article** sets forth such a special security interest.

Finally, a general word is in order relative to the role of the BNA and the Aviso. The Mission fully understands that it may be offering understandings of existing Angolan law that have not been articulated to this point. Given the unusual nature of factoring, this is not atypical in any country. The key is to use existing law to accommodate the realities of these transactions in a fast paced global environment. The objection may be made as to this **Recommended Article #5** that the BNA is making "new law" in an

Aviso. The Mission disagrees. Articles 4.2 and 6.2 of the Law on Financial Institutions give the BNA not only the authority to explain the transactions, but to impose conditions on them so as to make factoring operable. This is especially true in the SME environment. Articles 16 and 21 of the Law on the National Bank are also highly relevant. The former gives the BNA the authority to advise all organs of government on matters of finance, a subject that surely covers factoring. The latter article gives the BNA authority to supervise banks and non-banks, including in the area of factoring. The interpretation of existing Angolan law to make the transactions more acceptable is an aspect of BNA responsibility.

Recommended Article #6: This Article will stipulate that the security interest in property, subject to transfer to the factor in a factoring transaction, will be subject to a security interest noted above under the following conditions: (i) as to property subject to the Commercial Register, at the time of official recordation in the Commercial Register; and (ii) as to property not subject to recordation in the Commercial Register, upon the earlier of : (a) transfer of possession and use of the property, subject to a factoring agreement, to the factor; (b) execution of the contract related to factoring by the client to the factor; or (c) possession of negotiable instruments by the factor as to letters of credit, bills of lading, cheques and other negotiable instruments under the Commercial Code.

Proposed Aviso Language (Article #6): HIERARCHY OF SECURITY INTERESTS -*The security interest in property subject to transfer to the factor in a factoring transaction will be subject to a security interest noted in Article V under the following conditions:*

1. Concerning property subject to the Commercial Register, the security interest becomes effective at the time of official recordation in the Commercial Register; and

2. Concerning property not subject to recordation in the Commercial Register, the security interest becomes effective upon the earlier of: (a) transfer of possession and use of the property subject to factoring agreement to the factor; (b) execution of the contract related to factoring by the client to the factor; or (c) possession of negotiable instruments by the factor as to letters of credit, bills of lading, cheques and other negotiable instruments under the Commercial Code.

Explanation #6: International standards dictate that, if a system establishing security interests is created, the law needs to stipulate precisely when such an interest begins. This **Recommended Article** does so. As noted above, the scope of the Commercial Register is quite limited in terms of scope as to commercial property. And, even as to the property covered in the Commercial Register, interviews the week of July 21 confirm that time of registration as an internal administrative matter may vary, depending on the property registered. The **Recommended Article** is designed to provide clarity on the key issue of when the security interest arises. Article 122 of the Commercial Code very strongly implies that security interests fall within its ambit, at least as to the types of property covered by the Commercial Register. Meetings held the week of July 21 with Commercial Register officials and others confirm this.

The **Recommended Article** is intended to provide clarity here. Strictly speaking, banking regulation is not the logical place to set forth the rights of secured parties. However, three points should be made. First, the BNA is largely interpreting very general legal principles and making them applicable to leasing and factoring. Unlike the civil codes of many countries, the current Civil Code in Angola appears to contain few specific references to a law on pledges generally. The closest approximation appears to be a series of articles on mortgages. See Articles 686-735, Civil Code). While the articles include commercially significant items of property such as land and automobiles, key aspects reflecting modern commercial practice such as assignment and election of remedies relating recovery of property to indebtedness are not covered. The point is not that such features are not existent; but, rather, it is that, currently, the code is not designed to take the specifics of factoring into account. Hence, elaboration by the BNA as regulator seems appropriate.

Secondly, although international standards very much support the trend to detailed development as respects the rights of secured parties (including clear statements of when the right arises and priorities

among secured parties), it is very difficult to discern a clear trend as to how given jurisdictions arrive at a detailed expression of security interests. This is because the issue of the rights of secured parties is very much tied up with the issue of land transfer and mortgage, which is highly influenced by local traditions and preferences. Meetings the weeks of July 7 and 14 confirm this tendency in Angola. Therefore, BNA intervention as to the question of security interests in the context of factoring is appropriate. Thirdly, of course, Articles 4.2 and 6.2 of the Law on Financial Institutions mandate that the BNA develop definitions for the purpose of giving effect to factoring by banks and for regulating financing generally by non-bank financial institutions. Thus, the BNA has very broad authority to clarify key aspects of factoring. Surely this includes providing definitive guidance on the rights of secured parties, without which factoring will not occur.

As respects types of property covered in the **Recommended Article**, the intention is to cover various laws within the Commercial Code dealing with bills of lading, cheques and other negotiable property.

Proposed Language (Article #7): FUNDING (RECURSOS)-

1. Factoring entities ("sociedades de factoring") can only fund themselves through the use of their own capital and the following permissible sources of funds:

a. Issuing of any type of "commercial paper" under conditions permitted under the law and without compliance to limits set forth in the Code of Commercial Companies.

b. Financing from domestic and foreign sources in local or foreign currency as permitted by law.

c. Factoring companies are permitted to realize the foreign exchange operations necessary to exercise their activities.

d. Factoring entities are permitted to rediscount their paper with government financial institutions, subject to relevant laws, rules and regulations.

2. Factoring entities may participate in special loan, credit or insurance programs sponsored by or made available through government financial institutions. And,

3. The National Bank of Angola shall establish the minimum capital required of a factoring company.

Explanation #7: To enable factoring companies to conduct their business and to create quick and ample sources of working capital and liquidity for the market, especially Small and Medium Enterprises (SMEs), factoring companies must have a wide range of different sources of funding available to them. Not overly regulating or limiting these sources is expected to bring liquidity and growth to the market.

Recommended Article #8: This Recommended Article will establish the minimum requirements of a factoring contract.

Proposed Aviso Language (Article #8):

1. A written contract, accounts receivable financing agreement, or similar written document, along with the commercial conduct of the parties in question, shall summarize and describe the factoring ("cessao financeira") transaction among the participating parties.

2. The written agreement, a related schedule, or the commercial conduct of the parties shall include at least the following points:

a. Name and contact address of the parties to the transaction.

b. Date on which the underlying transaction was executed.

c. Date on which full payment of the discounted receivable or receivables is/are due.

d. Statement of whether the receivable is discounted with or without full recourse to the factor.

e. The amount due to the factor as full payment of the discounted receivable.

f. The total amount of the facility.

g. Other information which the parties to the contract (agreement) judge to be necessary to define the proposed activity, to describe the services to be provided, to clarify the proposed discounting of receivables, and to facilitate collections and payment. This includes proper documentation as well as representations and warranties as agreed by the contracting parties.

Any one of more of the above factors will support a determination by the National Bank of Angola that a transaction is a factoring transaction. Nothing herein shall be construed in derogation of the freedom of contract as guaranteed under law.

***Explanation #8**:* In many countries a "model contract" is used to guide and to regulate factoring companies. In our opinion, given the private, commercial nature of factoring transactions, this is unnecessarily limiting. Some account receivable financing agreements exceed thirty pages, others are very short. Any attempt to draft a model contract ("contrato padrao") would limit the applicability and potential growth of factoring as an efficient and welcomed financing instrument. The suggested minimum clauses represent a compromise and our suggestion is that the precise wording of any contracts be left to the business parties involved.

Recommended Article #9: This Recommended Article will set forth the continued applicability of incentives, granted by law or regulation, to purchasers, importers, borrowers, or other eligible persons in connection with any purchase when such purchase is financed through a factoring company.

Proposed Aviso Language (Article #)9: APPLICABILITY OF INCENTIVES AND EXEMPTIONS TO FACTORING TRANSACTIONS –

Any incentive, exemption or benefit, including tax credits and investment incentives granted by law or regulation to any purchaser, importer, borrower or other eligible person in connection with any purchase, importation, acquisition, or other transaction shall not be lost, diminished or impaired when the associated financing is through a factoring company ("sociedade de factoring") rather than through borrowing or other conventional methods of financing. Factoring Companies shall be entitled to any incentive, exemption, benefit or privilege available to lenders, importers, purchasers or other eligible person in such transactions under the applicable law or regulation.

Explanation #9: The intent of this article is to ensure that factoring remains competitive and desirable as a short-term generator of working capital. When drafting the final form of the proposed Aviso, we hope that factoring will be treated equally with other forms of financing, especially in conjunction with possible future incentives.

For instance, under current interpretation, in some cases the Stamp Tax ("Imposto de Selo") may be imposed more than once in a factoring transaction. Should that happen it may be appropriate to consider exemptions (from all or a portion of the Stamp Tax) for leasing and factoring transactions. We understand that this is beyond the BNA's authority, but suggest that such incentives be considered when attempting to encourage new financing tools.

Recommended Article #10: This Recommended Article asserts National Bank of Angola's supervisory powers over banks engaged in factoring and factoring companies and provides general guidelines for their supervision.

Proposed Aviso Language #10: SUPERVISION -

1. F*actoring transactions are short-term in nature and have commercial rather than banking characteristics. Therefore, monitoring and supervision requirements differ substantially from what is required and prudent with banks. In line with accepted international standards, BNA's examination and review procedures focus on the verification that the factoring company policies and procedures in place*

which are appropriate to the risks undertaken, that these policies have been implemented and are being followed, and that management monitors their implementation adequately and takes effective remedial action if necessary.

2. In general, factoring companies should parallel -- but are not mandated to follow -- the procedures for financial institutions outlined in Avisos No. 15/07 and No. 09/07of the 12th of September. Appropriate elements of these should be adopted as models to be used in accordance with the size and nature of the factoring company's level and volume of operations.

3. In its supervisory role BNA will periodically examine the degree to which factoring companies have adapted, adopted and implemented their own internal guidelines.

4. Banks engaged in factoring operations are regulated, supervised and reviewed by the National Bank of Angola as banking institutions.

Explanation #10: The degree to which Central Banks should have regulatory and supervisory powers over factoring is the subject of considerable discussion. Different models suggest various approaches. In Angola there is no question that the National Bank of Angola has been charged with the responsibility of regulating and supervising factoring. The question is how and to what degree.

In many countries (such as Mexico) factoring is recognized as a purely commercial – not banking – activity. For these reasons, in such environments it is no longer regulated by the Central Bank. To the extent that other reasons did not have a major impact, this commercial treatment allowed factoring to grow as a popular, useful and efficient way to raise short term funds and "to outsource" administrative, credit evaluation and collection services. This has been of particular value to small and medium sized enterprises.

In Mexico the legislation governing financial services was liberalized through a series of changes that began in 2005 and, in effect, de-regulated financial leasing and factoring companies. Factoring was regulated in Mexico from 1990 until the recent changes, when the government decided that strict regulation of leasing and factoring was unnecessary and counter-productive to its goals for the economy. Among the arguments were that excessive regulation inhibited competition, imposed an unnecessary administrative burden and that they inhibited financial innovation. This, the legislators argued, led to higher interest and overall operating costs. According to a 2006 study by Yves Hayaux-du-Tilly and Maria Jose Pinillos, "the Mexican government has considered that it is not necessary to regulate financial activities that involve taking risks by placing credits or loans…since the entities carrying out these activities do not receive funds from the general public through deposits or other forms and do not form part of the Mexican payments system and therefore there is no public interest to protect." In 2006, a new, unregulated entity was created and recognized in law to carry out leasing and factoring activities in Mexico (Sofomes). In Brazil, when factoring began in 1982, legislation affecting it was confusing and unclear. Predictably, the result was to delay the use of factoring as a truly effective financing tool. Today, the Central Bank does not regulate factoring, treating it as a commercial transaction. Yet, it is little used because of adverse, onerous tax consequences. Theoretically, in Brazil factoring involves a change of title to merchandise; in Brazil this would be undesirable because of an ICMS (equivalent to Value Added Tax) charge of 18%.

To encourage the growth of factoring as a desirable form of short-term financing in Angola, especially for small and medium sized enterprises, we recommend that the supervision of factoring companies focus on how well factoring companies develop and implement their own internal forms of control, audit and management. Different factoring companies, of different sizes and with differences in their sector or industry focus, should be encouraged to develop internal controls which are appropriate to their businesses and will enable management to remain efficient. It is recommended that BNA's supervision of banks engaged in factoring continue in accordance with BNA's current policies.

Recommended Article #11: This Article will state that failure by any bank or non- bank financial institution to adhere to the provisions of the law regarding factoring, including but not limited to this Aviso, may result in the imposition of such fines, penalties or other sanctions as are appropriately determined by the National Bank of Angola or by a court of law. Such sanctions may include, but are not limited to, sanctions for false or misleading statements in the course of business, including those relative to value of any interest or property, and any false or misleading statements in any application, report or document required to be filed under the law.

Proposed Language Article #11: SANCTIONS - *Failure by any bank or non- bank financial institution to adhere to the provisions of the law regarding factoring, including but not limited to this Aviso, may result in the imposition of such fines, penalties or other sanctions as are appropriately determined by the National Bank of Angola or by a court of law. Such sanctions may include, but are not limited to, sanctions for false or misleading statements in the course of business, including those relative to value of any interest or property, and any false or misleading statements in any application, report, or document required to be filed under the law.*

Explanation #11*:* Meetings with the BNA suggest that factoring may be especially prone to misrepresentations relative to value, risk and other key aspects of the transaction. The Recommended Article is designed to provide notice that the BNA and the courts will actively enforce the commercial law, thereby providing some assurances to the financial community. Such assurances are particularly key if factoring is to impact upon the small to medium business echelon of the Angolan economy.

APPENDIX: DOCUMENTS AND TEXTS CONSULTED

- **Official Legal Texts of Angola (in order of authority and then by alphabetical order)**
  - Civil Code of Angola (2005)
  - Code of Civil Procedure of Angola (2006)
  - Code "On Tax of Capital Investment" (1972)
  - Code "On Industrial Tax" (1972)
  - Commercial Code of Angola, Volume 1 (2006)
  - Law "On Distribution Contracts, Agencies, Franchising and Commercial Concessions" (2003)
  - Law "On Exchange" (1997)
  - Law "On Financial Institutions" (2005)
  - Law "On Foreign Investment" (1994)
  - Law "On the National Bank" (1997)
- **Official Legal Texts from Outside Angola (in order of authority and then by alphabetical order)**
  - Article 2A, Uniform Commercial Code, United States (in effect in 49 of the 50 states) (date as adopted in each state)
  - Article 9, Uniform Commercial Code, New York Consolidated Laws Service (1964, as amended 1978, and several additional amendments)
  - Article 45, Personal Property Law, New York Consolidated Laws Service, (circa 1964)
  - Federal Law "On Leasing," The Russian Federation (1998).
  - Law "On Leasing," Republic of Egypt, 1995.
  - Government Ordinance No. 51/28 "On Leasing and Leasing Societies," Republic of Romania (1997).
  - Ordinance # 2,309 on Leasing, Central Bank of Brazil (1996).
  - United States Code, 12 U.S.C. Section 1020 et seq.
- **Regulations for Angola**
  - Aviso No. 05/07, (on solvency ratios and financial regulation), National Bank of Angola,2007.
  - Aviso No. 06/07, (on risk exposure in exchange), National Bank of Angola,2007.
  - Aviso No. 07/07, (on immoveable property), National Bank of Angola,2007.
  - Aviso No. 13/07, (on creation of financial institutions), National Bank of Angola,2007.
  - Aviso No. 13/07, (on credit operations), National Bank of Angola,2007.
  - Aviso No. 13/07, (on classification of credits), National Bank of Angola,2007.
  - Aviso No. 15/07, (on regulation of patterns of economic behavior demonstrated by financial institutions), National Bank of Angola, 2007.
- **Guidelines for International Standards - Legal Authority**

- International Institute for the Unification of Private Law (UNIDROIT), Unidroit Convention on International Financial Leasing, Ottawa, Canada, 1988.
- UNIDROIT Model Law on Leasing (2005). (with some 2008 updates)

- **Reports and Other Documents (in alphabetical order)**
  - ANZ V-TRAC Company, Seminar on Operating Leases, Organized by the State Bank of Vietnam, 2002.
  - International Finance Corporation IFC and the Leasing Sector, Washington, DC, circa 2002.
  - Leasing - Relação de Consumidor (leasing in Portugal)
  - Merrill Lynch, Pierce, Fenner & Smith Inc., How to Read a Financial Report, New York, New York, circa 1983.
  - National Conference of Commissioners on Uniform State Laws, A Summary Uniform Commercial Code, Article 2A Amendments (1990), 1990.
  - Shapiro, Samuel and Albert Reisman, Equipment Leasing in the 1970s, Practicing Law Institute, New York, New York, 1973.
  - The Conference Board, Leasing in Industry, Studies in Business Policy, No. 127. New York, New York, 1968.
  - The Services Group, Inc. and Nathan Associates, Southern Africa Global Competitiveness Club, Developing the Supply of Financial Services and Improving the Efficacy of the Banking Sector in Angola, 2008.
  - United States Agency for International Development and National Bank of Angola, Operationalizing Leasing and Factoring in Angola, 2008.